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Supreme Court, U.S.
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IN THE
Supreme Court of the United States

VISION SERVICE PLAN,
Petitioner,

v.

THE UNITED STATES OF AMERICA,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Consistent with the IRS's longstanding position and Congress's intent, whether a nonprofit health care organization that provides benefits to a broad and substantial class of subscribers qualifies for tax exemption as a "social welfare" organization pursuant to section 501(c)(4) of the Internal Revenue Code of 1986.

CORPORATE DISCLOSURE STATEMENT

Pursuant to Supreme Court Rule 29.6, petitioner states that it has no parent companies and no publicly owned company owning 10% or more of its stock.

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JURISDICTION

The court of appeals entered judgment on January 30, 2008. On April 9, 2008, the court denied a timely petition for rehearing and suggestion for rehearing *en banc*. App. 26a. On June 19, 2008, Justice Kennedy extended the time for filing this petition to and including August 7, 2008. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES AND REGULATIONS INVOLVED

The most directly pertinent portions of section 501 of the Internal Revenue Code of 1986 provide as follows:

> (a) EXEMPTION FROM TAXATION
>
> An organization described in subsection (c) or (d) or section 501(a) shall be exempt from taxation under this subtitle unless such exemption is denied under section 502 or 503.
>
> ...

(c) LIST OF EXEMPT ORGANIZATIONS:

The following organizations are referred to in subsection (a):

...

(3) Corporations ... organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or [for certain other purposes, and within limitations on political activities and private inurement].

(4)(A) Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare ... and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.

...

(m) CERTAIN ORGANIZATIONS PROVIDING COMMERCIAL-TYPE INSURANCE NOT EXEMPT FROM TAX

(1) DENIAL OF TAX EXEMPTION WHERE PROVIDING COMMERCIAL-TYPE INSURANCE IS SUBSTANTIAL PART OF ACTIVITIES

An organization described in paragraph (3) or (4) of subsection (c) shall be exempt from tax under subsection (a) only if no substantial part of its activities consists of providing commercial-type insurance.

...

(3) COMMERCIAL-TYPE INSURANCE

For purposes of this subsection, the term "commercial-type insurance" shall not include —

(A) insurance provided at substantially below cost to a class of charitable recipients,

(B) incidental health insurance provided by a health maintenance organization of a kind customarily provided by such organizations;

....

Code sections 501(a), 501(c)(3)-(4), and 501(m), are set forth in their entirety at App. 27a-30a.[1]

The term "social welfare," used in section 501(c)(4), is not defined in the Code. Treasury Regulation § 1.501(c)(4)-1(a)(2) provides in part:

(i) *In general.* An organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community. An organization embraced within this section is one which is operated

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[1] In this petition, all references to the "Code," and all statutory citations that do not include the United States Code title, are to the Internal Revenue Code of 1986, as amended.

> primarily for the purpose of bringing about civic betterments and social improvements.

The entirety of Treasury Regulation § 1.501(c)(4)-1, which is the only regulation addressing section 501(c)(4) of the Code, is set forth at App. 30a-32a. No regulations have been issued under section 501(m).

STATEMENT OF THE CASE

This case presents a critically important, recurring question regarding the standards governing the tax-exempt status of nonprofit health care enterprises, particularly nonprofit health maintenance organizations (HMOs). Under the common law, which this Court has held is reflected in section 501(c) of the Internal Revenue Code, nonprofit health care organizations are deemed "charitable" entities that promote the "social welfare," and are thus entitled to tax-exempt status, as long as the class of subscribers is not so small that the public benefits are insubstantial. Consistent with the common law, the IRS has long taken the position that nonprofit HMOs, including petitioner Vision Service Plan (VSP), are eligible for tax-exempt status. Indeed, the IRS granted VSP a tax exemption in 1960.

Without any change in statutory or regulatory law, and without any change in the operations of VSP, the IRS overturned its longstanding position, revoking VSP's tax exemption in 2002. According to the IRS, a nonprofit health care organization that limits its benefits to a class of subscribers is no longer eligible for tax-exempt status, unless it also provides some as-yet-unquantified, unspecified

amount of "community benefits." By condoning the IRS's unfounded departure from the common law in a cursory, unpublished decision, the Ninth Circuit has cast tax exemption law into turmoil, introducing unprecedented uncertainty in a nonprofit industry that relies on tax exemptions in order to fulfill its basic mission of providing health care for the benefit of the community to all applicants. Indeed, the Ninth Circuit's ruling calls into question the tax exemptions for all nonprofit health care organizations, including not just otherwise qualified health plans and HMOs, but also hospitals, nursing homes, and others.

This is directly contrary to Congress's clearly expressed intent. In 1986, Congress struck a balance in determining which nonprofit health care organizations should be exempt from taxes. Section 501(m) of the Code denies a tax exemption to "charitable" and "social welfare" organizations (*i.e.*, section 501(c)(3) and (4) organizations) that offer "commercial-type insurance," such as Blue Cross and Blue Shield. At the same time, however, section 501(m) acts as a savings clause, expressly preserving the existing tax exemption for nonprofit HMOs that do not offer commercial-type insurance. Because nonprofit HMOs are, by their very nature, organizations that provide benefits to a class of subscribers, the IRS's position therefore contravenes Congress's determination that these entities should be eligible for tax-exempt status.

The standards governing the availability of tax exemptions to nonprofit organizations in the health care field is an important issue of federal law that has not been, but should be, decided by this Court.

Because of the billions of dollars involved in this industry and the potentially adverse impact on public health and the cost and availability of health care, the issue should not await the development of a conflict in the circuits. More than enough confusion and uncertainty exists already.

A. The Petitioner, Vision Service Plan.

VSP is a California nonprofit corporation established in 1955 and licensed under California's Knox-Keene Health Care Service Plan Act of 1975 (Cal. Health & Safety Code § 1340 *et seq.*). VSP offers only a single service: vision care. It provides prepaid medical service plans, primarily covering eye examinations and corrective lenses, that deliver services through a network of private practice optometrists and ophthalmologists. VSP contracts with these providers at a discount from their usual and customary rates.

In 1960, the IRS recognized VSP's tax-exempt status under section 501(c)(4). VSP's organization and operations have not changed in any material way since that time, except that it has grown significantly in size and thus serves ever broader portions of the community. Beginning in 1960 as a regional provider, VSP along with its affiliates has become a national provider of vision care.

As a nonprofit entity providing care to a large segment of the community, VSP pursues a goal of maximizing delivery of health care services within the limits of its financial capacity, rather than maximizing net income:

- in 2003, the tax year in question, VSP had over 6 million enrollees, more than 40% of whom were poor or elderly beneficiaries of Medicaid, Medicare, or similar state programs;

- VSP provides millions of dollars in free vision services to uninsured or underinsured children and victims of disasters;

- even for those subscriber groups who participate at full rates, VSP has negotiated discounts with its contract providers of 20% or more off the providers' usual and customary rates, with even deeper discounts for services provided to Medicare and Medicaid patients;

- over a third of the providers in VSP's network are in medically underserved communities;

- VSP has no blackout provisions on enrollment and no limitation for pre-existing conditions;

- VSP has a substantial program of community outreach and patient education on the health benefits of annual comprehensive eye examinations;

- VSP uses its accumulated surplus and reserves for the purpose of providing a business safety net and improving the cost effectiveness and quality of the eye care services it provides;

- no part of VSP's net revenues or assets can inure to any private person or be distributed as dividends; VSP's by-laws preclude such inurement; and

- VSP's Articles of Incorporation affirm its nonprofit business model: the Articles require that if the organization dissolves, its remaining assets are to be distributed "to an educational, research, scientific or health institution, organization, or association to be expended in the advancement of the science and art of optometry."

Thus, in contrast to for-profit commercial insurers, VSP is not investor-owned, and it provides benefit plans to subscribers without regard to traditional insurance risk analyses (*i.e.*, pre-existing conditions for profit underwriting guidelines). Despite these stark differences, in 2002, the IRS determined that VSP should be taxed as if it were a for-profit commercial insurer. The IRS revoked VSP's tax-exempt status, prospectively, on the ground that it was not "operated primarily for the promotion of social welfare." Neither in 2002 nor in the course of discovery and argument did the IRS contend that VSP's operations had changed since 1960 when the IRS granted VSP a tax exemption.

VSP paid taxes for 2003 and sued for a refund in the United States District Court for the Eastern District of California. The District Court had jurisdiction under 28 U.S.C. § 1346(a)(1).

B. The Proceedings Below.

1. The District Court granted summary judgment for the government. The District Court determined that VSP is not eligible for a tax exemption because "VSP's primary purpose is to serve VSP's paying members." App. 14a. The District Court recognized that "VSP does provide

services through charity programs," but it concluded that "these services to non-enrollees are not, comparatively, substantial...." App. 14a. In the District Court's view, "VSP is operating primarily for the benefit of its subscribers rather than for the purpose of benefitting [*sic*] the community as a whole." App. 18a.[2] The District Court thus would deny 501(c)(4) tax-exempt status to any HMO that limits its benefits to a class of subscribers, no matter how large that class.[3]

2. The Ninth Circuit affirmed. That court gave VSP's appeal short shrift. In a memorandum decision, it stated, without analysis, that VSP is not eligible for tax-exempt status because its "primary purpose" is to "benefit[] VSP's subscribers rather than the general welfare of the community." App. 2a. The Ninth Circuit recognized that "VSP offers some public benefits," but concluded that VSP's

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[2] The District Court also found that VSP's primary activity was "carrying on a business with the general public in a manner similar to organizations which are operated for profit." App. 23a (quotations omitted). The Ninth Circuit expressly refused to reach this issue. App. 3a.

[3] The District Court also seemed to conclude that VSP is not an HMO because it arranges to provide health care services through contract physicians rather than providing the services through physician employees. App. 15a. While the Ninth Circuit did not address this point, the District Court's conclusion is clearly erroneous. Both the IRS and this Court have recognized that "HMOs directly provide *or arrange for* the provision of health care services to members on a prepaid basis." Internal Revenue Manual § 4.76.31.2(1) (emphasis added); *see also Rush Prudential HMO, Inc. v. Moran*, 536 U.S. 355, 367 (2002) (the "defining feature of an HMO is receipt of a fixed fee for each patient enrolled under the terms of a contract to provide specified health care if needed") (citation omitted).

subscriber-based structure precluded it from finding that those benefits are "enough for us to conclude that VSP is primarily engaged in promoting the common good and general welfare of the community." App. 2a (emphasis removed). The court did not explain why VSP's "subscribers" were not a sufficiently large body that the promotion of their health care was of benefit to "the common good." Nor did the court explain how its decision could be squared with the common law or the IRS's previously-held position that health care itself is a mission that benefits social welfare.

REASONS FOR GRANTING THE PETITION

I. The Decision Below Conflicts With Longstanding Common Law Principles And Congress's Intent To Preserve Nonprofit HMOs' Tax-Exempt Status.

The Ninth Circuit's decision turns on the premise that an HMO providing health care to a broad but limited class of patients, *i.e.*, less than all members of the community, does not qualify for a 501(c)(4) exemption. This is directly contrary to the common law of charitable trusts, which this Court has held guides interpretation of the Code's charitable exemptions, and which provides that health care is a "charitable" purpose. It is also in conflict with Congress's 1986 judgment that nonprofit HMOs *are* entitled to tax-exempt status. If allowed to stand, the Ninth Circuit's decision will allow the IRS to proceed on an uncertain and unprecedented course, stripping HMOs of a tax-exempt status that enables these organizations to

fulfill their basic, "charitable" mission of providing health care.

1. Tax exemptions for nonprofit "charitable" and "social welfare" organizations have been part of federal income tax law at least since the Revenue Act of 1913, Pub. L. No. 63-16, § 2(G), 38 Stat. 114, 172. These terms are not defined in the statute. However, this Court has observed that the "common law of charitable trusts" should guide interpretation of the "charitable exemption and deduction sections" of the various tax laws. *Bob Jones Univ. v. United States*, 461 U.S. 574, 588 n.12 (1983), *citing, e.g.*, H.R. REP. NO. 91-413, pt. 1, at 43 (1969) (describing "charitable" as "a term that has been used in the law of trusts for hundreds of years"). Similarly, Treasury Regulations provide that "[t]he term 'charitable' is used in section 501(c)(3) in its generally accepted legal sense." Treas. Reg. § 1.501(c)(3)-1(d)(2).

The common law of charitable trusts leaves no doubt that the promotion of health is in itself a charitable purpose.[4] This is true regardless of the percentage of needy patients: relief of poverty is a possible, but not essential, object of "charity." IV-A WILLIAM F. FRATCHER, SCOTT ON TRUSTS § 372 (4th ed. 1989). Moreover, the charitable character of a health care institution is not lost simply because patients pay for the care that they receive.[5] Nor is

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[4] *See, e.g.*, 2 RESTATEMENT (SECOND) OF TRUSTS § 372, comment *a* (1959); GEORGE G. BOGERT & GEORGE T. BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 374 (2d ed. rev. 1991); IV-A WILLIAM F. FRATCHER, SCOTT ON TRUSTS § 372 (4th ed. 1989).

[5] *See, e.g., Butterworth v. Keeler*, 219 N.Y. 446, 449, 114 N.E. 803, 804 (1916) (Cardozo, J.) ("What controls is not the receipt of income, but its purpose."); RESTATEMENT § 372

the charitable character of the institution lost simply because its subscribers are limited to fewer than all members of the community, provided that the number of subscribers is not so small as to be of no practical benefit to the community. 2 RESTATEMENT (SECOND) OF TRUSTS § 372, comment *c* (1959) (hereinafter "RESTATEMENT"); *id.* § 375; GEORGE G. BOGERT & GEORGE T. BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 365 (2d ed. rev. 1991); SCOTT ON TRUSTS §§ 372, 375.

Under the common law of charitable trusts, therefore, VSP is a charitable entity even though the entire public does not participate in VSP's prepaid vision service plans. As the Tax Court held in one of the earliest HMO tax exemption cases:

> To our knowledge, no charity has ever succeeded in benefiting every member of the community. If to fail to so benefit everyone renders an organization noncharitable, then dire times must lie ahead for this nation's charities.

Sound Health Ass'n v. Comm'r, 71 T.C. 158, 185 (1978), *acq.* 1981-2 C.B. 1. If the rule were otherwise, well-known and highly respected nonprofit HMOs could lose their tax exemptions, as could many nonprofit hospitals.[6]

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comment *c*; BOGERT ON TRUSTS & TRUSTEES § 364; SCOTT ON TRUSTS § 372; *E. Kentucky Welfare Rights Org. v. Simon*, 506 F.2d 1278, 1287-1288 (D.C. Cir. 1974), *vacated for plaintiffs' lack of standing*, 426 U.S. 26 (1976).

[6] Similar principles apply to educational and religious institutions, which also provide many services that directly benefit only their students or congregants. *See, e.g., Bethel*

Before revoking VSP's tax-exempt status in 2002, the IRS had long agreed with this position. In 1969, the IRS declared that the "promotion of health" is "one of the purposes in the general law of charity that is deemed beneficial to the community as a whole, *even though the class of beneficiaries eligible to receive a direct benefit from its activities does not include all members of the community*, ... provided that the class is not so small that its relief is not of benefit to the community." Rev. Rul. 69-545, 1969-2 C.B. 117 (emphasis added). This ruling made clear that a health care organization that serves a limited but broad class of subscribers, as most HMOs do, is engaged in a "charitable" purpose. The IRS's ruling was grounded in the common law of charitable trusts, and it accurately reflected that law. *See, e.g.*, RESTATEMENT §§ 368, 375. *See generally* Robert S. Bromberg, *The Charitable Hospital*, 20 CATH. U. L. REV. 237 (1970) (authored by the IRS lawyer who drafted Revenue Ruling 69-545).

2. The IRS granted VSP a tax exemption under 501(c)(4), which uses the term "social welfare," rather than 501(c)(3)'s "general law of charity." But this should have made no difference. Well-established law makes clear that the two sections are *in pari material*, and therefore must be construed together. *See generally Estate of Sanford v. Comm'r*, 308 U.S. 39, 44 (1939); *United States v. Freeman*, 44 U.S. 556, 564-565 (1845).[7] Consistent with this

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Conservative Mennonite Church v. Comm'r, 746 F.2d 388, 391 (7th Cir. 1984).

[7] "[T]he primary difference between the two ... is that organizations qualifying under § 501(c)(3) are restricted from substantial involvement in attempts to influence legislation, whereas § 501(c)(4) organizations have greater flexibility in

proposition, "[t]he IRS has a considerable propensity to import federal tax law principles applicable to tax-exempt charitable organizations to shape the law applicable to exempt social welfare organizations." THOMAS K. HYATT & BRUCE R. HOPKINS, THE LAW OF TAX-EXEMPT HEALTHCARE ORGANIZATIONS 3 (2d ed. 2007 Cum. Supp.).[8]

Thus, the IRS has specifically recognized that 501(c)(4)'s "social welfare" organizations are a *broader* group than the "charitable" organizations of 501(c)(3). *See N. Calif. Central Servs., Inc. v. United States*, 591 F.2d 620, 625 (Ct. Cl. 1979). Indeed, the IRS typically has used section 501(c)(4) as a "convenient pigeonhole ... for organizations that, although worthy, failed to meet the particular requirements of other 501(c) subsections," especially "prepaid medical service organizations." IRS Gen. Couns. Mem. (G.C.M.) 34,709 (Dec. 7, 1971). *See generally* James J. McGovern, *Federal Tax Exemption of Prepaid Health Care Plans*, 7 TAX ADVISER 76 (1976).

Consistent with the common law and with the IRS understanding of the relationship between 501(c)(3) and 501(c)(4), the IRS for many years accepted nonprofit health care organizations such as

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that field." *N. Calif. Central Servs., Inc. v. United States*, 591 F.2d 620, 625 (Ct. Cl. 1979) (summarizing Government's position); *see also Regan v. Taxation with Representation of Wash.*, 461 U.S. 540, 546 (1983).

[8] Not in this case, however. Contrary to its earlier litigating position in *N. Calif. Central Servs., supra* n.7, in this case the Government has argued that cases involving exemption section 501(c)(3) are "inapposite"; and the district court agreed. App. 10-11a n.2. The Ninth Circuit did not address the issue.

VSP, the Blue Cross and Blue Shield organizations, and other HMOs as tax-exempt under 501(c)(4), and occasionally under 501(c)(3). *See* Otto Shill, *Revocation of Blue Cross & Blue Shield's Tax Exempt Status: An Unhealthy Change?*, 6 B.U. J. TAX L. 147, 150 (1988); *Developments in the Health Care Field: A Story of Dramatic Change*, at unnumbered p. 2, *in* IRS EXEMPT ORGANIZATIONS, TECHNICAL INSTRUCTION PROGRAM FOR 1988, *at* www.irs.gov/pub/irs-tege/eotopicc88.pdf.

3. In 1986, Congress reviewed the tax-exempt status of health care companies in light of changes in the health care marketplace, particularly the increase in competitive, for-profit health insurers. As part of the Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085, Congress adopted what is now Code section 501(m). This section denies a tax exemption under 501(c)(3) and 501(c)(4) to organizations that offer "commercial-type insurance."[9]

At the same time that it revoked tax exemptions for providers of "commercial-type insurance," however, Congress expressly retained the existing tax-exempt status for nonprofit HMOs, including HMOs offering supplemental services such as vision or dental plans. Section 501(m)(3)(B) thus provides that "commercial-type insurance" should *not* include "incidental health insurance provided by a health maintenance organization of a kind customarily

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[9] This provision was aimed specifically at the exemptions of the Blue Cross and Blue Shield organizations. *See, e.g.*, Shill, *supra*, at 147; H.R. REP. NO. 99-426, at 664 (1985), *reprinted in* 1986-3 C.B. (vol. 2), at 664.

provided by such organizations." The Conference Committee report explained:

> [O]rganizations that provide supplemental health maintenance organization-type services (such as dental services) are not affected [by section 501(m)] if they operate in the same manner as a health maintenance organization.

H.R. REP. NO. 99-841, at 345 (1986) (Conf. Rep.), *reprinted in* 1986-3 C.B. (vol. 4) 346.

Two years later, the Conference Report for the Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, 102 Stat. 3700, confirmed that Congress intended a "general exemption for health maintenance organizations," as well as for "organizations that provide supplemental ... services (such as dental or vision services) ... if they operate in the same manner as a health maintenance organization." H.R. REP. NO. 100-1104, at 9 (1988), *reprinted in* 1988-3 C.B. 473, 499.

Congress's judgment should have been determinative in this case. Instead, the Ninth Circuit's decision upholds the IRS's narrow (and erroneous) interpretation of section 501(c)(4) as excluding HMOs that do not provide "enough" additional public benefits. Such a reading would trump Congress's intent that section 501(m)(3) operate as a savings clause for nonprofit HMOs: Congress provided in section 501(m)(3) that HMOs that do *not* provide commercial-type health insurance are still eligible for tax-exempt status.

As this Court has previously made clear in the tax exemption context, the Ninth Circuit's interpretation of the Code is fundamental error. "[I]t is a basic principle of statutory construction that a specific statute, here subsection [501](e), controls over a general provision such as subsection [501](c)(3)." *HCSC-Laundry v. United States,* 450 U.S. 1, 6 (1981). This is "particularly" true when it is consistent with the legislative history and "when the two [provisions] are interrelated and closely positioned, both in fact being parts of § 501 relating to exemption of organizations from tax." *Id.* What was true of sections 501(c)(3) and 501(e) in *HCSC-Laundry* is true of sections 501(c)(4) and 501(m) in this case. The latter is the specific provision in which Congress expressed its intent that HMOs offering incidental health insurance, such as vision and dental care, should continue to be eligible for tax exemptions.

The IRS has deliberately ignored this congressional judgment. It has backed away from its prior ruling that a health care organization is eligible for tax-exempt status, "even though the class of beneficiaries eligible to receive a direct benefit from its activities does not include all members of the community." Quite to the contrary, the IRS has now proclaimed that it "do[es] not interpret [501(m)(3)(B)] as evidence of congressional intent to generally except HMOs from the proscription of IRS 501(m)(1)." John Francis Reilly et al., *IRC 501(c)(4) Organizations, in* IRS EXEMPT ORGANIZATIONS, TECHNICAL INSTRUCTION PROGRAM FOR FY 2003, at I-33. But that is exactly what Congress intended, as both the statutory language and its legislative history make clear. *See* DOUGLAS M. MANCINO,

TAXATION OF HOSPITALS AND HEALTHCARE ORGANIZATIONS § 6.03 (2d ed. 2005).

The IRS's changed position – now condoned by the Ninth Circuit – makes it much more difficult for a nonprofit health care organization to qualify for an exemption under sections 501(c)(3) or 501(c)(4). Despite the fact that the basic mission of these organizations is a charitable one – the promotion of health care – the IRS now requires something more in the way of "community benefits" or "public benefits" in order to qualify for an exemption. *See, e.g.*, John M. Quirk, *Turning Back the Clock on the Health Care Organization Standard for Federal Tax Exemption*, 43 WILLAMETTE L. REV. 69, 76 (2007). This movement has been applauded by some[10] and criticized by others,[11] but both supporters and critics agree that the change has occurred. *See also* THOMAS K. HYATT & BRUCE R. HOPKINS, THE LAW OF TAX-EXEMPT HEALTHCARE ORGANIZATIONS 165 (3d ed. 2007).

The decision below reflects the most extreme example yet of the IRS's change in position. The IRS has not contended in this litigation that VSP offers "commercial-type insurance," an offering that would bar exemption under section 501(m).[12] Instead, the

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[10] *See, e.g.*, John D. Colombo, *The Failure of Community Benefit*, 15 HEALTH MATRIX 29 (2005).

[11] *See, e.g.*, Douglas M. Mancino, *The Impact of Federal Tax Exemption Standards on Health Care Policy and Delivery*, 15 HEALTH MATRIX 5 (2005).

[12] The IRS did contend in the lower courts that VSP's "primary activity ... is carrying on a business with the general public in a manner similar to organizations which are operated for profit," Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii), and the District Court so found, App. 25a; but the Ninth Circuit expressly

IRS has wrongly sought to impose even more restrictive limits than section 501(m)(3) imposes. The IRS would limit the promotion of "social welfare" under section 501(c)(4) to organizations that are either not subscriber-based, or subscriber-based but provide "enough" additional community benefits. Despite its changed position, the IRS has not withdrawn Revenue Ruling 69-545, which is plainly inconsistent with its new position. *See* Douglas M. Mancino, *The Impact of Federal Tax Exemption Standards on Health Care Policy and Delivery*, 15 HEALTH MATRIX 5 (2005); Bromberg, *supra*. Nor has it promulgated regulations under section 501(m)(3) to explain or clarify its position. Rather, the IRS's new position introduces unwarranted and needless uncertainty and risk into the nonprofit health care sector and beyond, despite the absence of new legislation or regulation.

VSP fits squarely within section 501(m)(3)'s savings clause, *i.e.*, it is an HMO that does not offer commercial-type insurance. The IRS's more stringent interpretation of sections 501(m)(3) and 501(c)(4) is contrary to Congress's intent and the IRS's prior position granting tax exemptions to entities like VSP.

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declined to rest its decision on this basis. App. 3a. The subsequent congressional decision reflected in section 501(m) effectively supersedes the regulation, as it applies to nonprofit HMOs such as VSP. *See Chevron U.S.A. Inc. v. Natural Res. Defense Council*, 467 U.S. 837, 842-843 (1984) (legislative judgment controls).

II. VSP Is Exactly The Sort Of Nonprofit Organization That Congress Intended To Remain Tax-Exempt.

VSP is an HMO for federal tax purposes. "The defining feature of an HMO is receipt of a fixed fee for each patient enrolled under the terms of a contract to provide specified health care if needed." *Rush Prudential HMO, Inc. v. Moran*, 536 U.S. 355, 367 (2002). In the evolution of the health care industry, HMOs are moving away from the original staff or group model, in which services are rendered by employees or by a closely affiliated medical group, to what is referred to as a contract or network model, such as the one that VSP uses. *See generally U.S. Health Care, Inc. v. Healthsource, Inc.*, 986 F.2d 589, 591-592 (1st Cir. 1993) (describing evolution of HMOs from use of physician employees to use of contract physicians).

The IRS attempts to distinguish staff-model HMOs, which it describes as "providers," from contract-model HMOs such as VSP, which it disparages as mere "arrangers" of health-care services.[13] Section 501(m) makes no such distinction,

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[13] *See, e.g.*, Leah D. Embry Thompson & Robert K. Kolbe, *Federal Tax Exemption of Prepaid Health Care Plans After IRC 501(m)*, at unnumbered p. 16, *in* IRS EXEMPT ORGANIZATIONS, TECHNICAL INSTRUCTION PROGRAM FOR FY 1992, *at* www.irs.gov/pub/irs-tege/eotopicl92.pdf:

> The Service continues to hold that only HMOs that provide medical services, with only incidental insurance attributes, are covered by the IRC 501(m)(3)(B) exception. In all other cases, the insurance aspects outweigh the service aspects.

and the legislative history shows that none was intended.

Congress was well aware that HMOs take various forms. The Conference Committee report on the Tax Reform Act of 1986 observed:

> HMOs provide physician services in a variety of practice settings primarily through physicians who are either employees or partners of the HMO or through contracts with individual physicians or one or more groups of physicians (organized on a group practice or individual practice basis).

H.R. REP. NO. 99-841, *supra*, at 346. In the statute, Congress drew no distinction between "providers" and "arrangers," such as the one the IRS seeks to make.

The legislative history of section 501(m) is also explicit that supplementary vision and dental plans, of the sort provided by VSP, were the type of "incidental health insurance" Congress had in mind. *See id.*; STAFF OF THE JOINT COMMITTEE ON TAXATION, GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1986, at 585-586.

Nor did Congress make HMOs' continued tax-exempt status depend on their provision of free care. Care offered substantially below cost is specified in section 501(m)(3)(A) as a separate exclusion from "commercial-type insurance." HMO-type organizations excluded under section 501(m)(3)(B) are not required also to satisfy the test of section 501(m)(3)(A).

The IRS's revocation of VSP's tax-exempt status, over 40 years after it was initially granted, represents an unauthorized departure from the established law of charitable trusts and from the specific judgment of the 1986 Congress, as well as from the IRS's own interpretation of section 501 expressed in Revenue Ruling 69-545. The IRS lacks any authority in legislation or in its own regulations for this departure.

III. It Is Vitally Important To A Large Sector Of The American Economy That The Question Presented Be Resolved Without Delay.

The uncertain state of tax exemptions for nonprofit health care organizations in general, and for HMOs in particular, is an area of "white-hot controversy." Travis L. Blais, *California Judge Makes Hash of Tax Exempt HMOs in Vision Service Plan*, 7 TAX & FINANCE 8-10 (Spring 2006) (newsletter of Tax & Finance Practice Group of American Health Lawyers Ass'n). "[T]he current state of the law in this area can only be characterized as incoherent." Richard L. Schmalbeck, *The Impact of Tax-Exempt Status: The Supply-Side Subsidies*, 68 LAW & CONTEMP. PROBS. 121, 129 (2006). "[N]onprofit health care organizations have entered an era of palpable uncertainty about what they must do to retain valuable exemptions." Quirk, *supra*, at 105.

The decisions below, although not published in the Thomson/West reports of federal decisions, have been closely followed by practitioners in the area. The revocation of VSP's tax exemption has been severely and correctly criticized as "inconsistent with clearly expressed congressional intent, recent

Supreme Court precedent, state regulatory schemes, and well-established IRS administrative practice." Christopher M. Jedrey & Charles R. Buck, *Health Care Organizations*, TAXATION OF EXEMPTS 280 (May/June 2006).

The conclusion reached by the courts below, that serving primarily fee-paying users precludes tax-exempt status, means "the loss of tax-exempt status for almost all currently tax-exempt HMOs. The implications of such an IRS position for hospital tax-exempt status also would be troubling." *Id.* at 282. Moreover, the Ninth Circuit's assertion that VSP's "public benefits" are "not enough" to qualify it for tax exemption, without any explanation or guidance as to what is "enough," or how it should be determined, only exacerbates the difficulty of tax planning for such organizations, and is plainly wrong.

The health care segment of the economy is critically important. In 2006 domestic health care spending amounted to $2.1 trillion, or $7,026 per person. Aaron Catlin et al., *National Health Spending in 2006: A Year of Change for Prescription Drugs*, 27 HEALTH AFFAIRS 1, 14 (2008). About half of the revenues in this portion of the economy are earned by nonprofit organizations. *See* BUREAU OF THE CENSUS, 2006 SERVICE ANNUAL SURVEY, NAICS 62, HEALTH CARE AND SOCIAL ASSISTANCE SERVICES Tables 8.1 & 8.5, *available at* http://www.census.gov/svsd/www/services/sas/sas_data/62/2006_NAICS62.pdf. Almost 90 percent of the revenues of these nonprofit health care organizations comes from the delivery of goods and services to those that they serve rather than from contributions. KENNARD T.

WING ET AL., THE NONPROFIT ALMANAC 2008, at 178 (The Urban Inst. 2008). The court of appeals' decision that there must be "enough" "public benefits" of an unspecified type to outweigh by some undefined measure the health care provided to paying patients, puts the tax-exempt status of all such organizations at risk.

Uncertainty about their tax-exempt status removes much of the incentive for these health care organizations to remain nonprofit. Conversion of such organizations to tax-paying, profit-maximizing status, as happened with many of the Blue Cross and Blue Shield organizations following the loss of their tax exemptions in 1986, has serious implications for the public health and welfare. Studies have repeatedly shown the superior quality of care provided through nonprofit HMOs compared to that provided through for-profit HMOs. *See* John P. Geyman, *The Corporate Transformation of Medicine and Its Impact on Costs and Access to Care*, 16 J. AM. BD. OF FAM. PRAC. 443, 444 (2003); David U. Himmelstein et al., *Quality of Care in Investor-Owned vs. Not-for-Profit HMOs*, 282 J.A.M.A. 159 (July 14, 1999); Robert Kuttner, *Must Good HMOs Go Bad? The Commercialization of Prepaid Health Care, Parts I and II*, 338 N.E.J.M. 1558, 1635 (May 21 & 28, 1998). *See also* Mark Schlesinger & Bradford H. Gray, *How Nonprofits Matter in American Medicine, and What To Do About It*, HEALTH AFFAIRS w287-w303 (June 2006) (superior performance of nonprofit hospitals and nursing homes).

CONCLUSION

The result below threatens established tax practice and congressional intent alike; and it jeopardizes the tax-exempt status of an important segment of the economy. The ruling that VSP's "public benefits" were "not enough" to justify a tax exemption for an HMO provides the industry with no guidance at all, where guidance is urgently required. The issues are clearly presented. The petition for a writ of certiorari should be granted.

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August 7, 2008

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United States Court of Appeals, Ninth Circuit.
VISION SERVICE PLAN, INC., Plaintiff-Appellant
v.
UNITED STATES of America, Defendant-Appellee.
No. 06-15269.

D.C. No. CV-04-01993-LKK.

Appeal from the United States District Court
for the Eastern District of California,
Lawrence K. Karlton, District Judge, Presiding.

Argued and Submitted
December 5, 2007
San Francisco, California

Filed Jan. 30, 2008.

Before: KOZINSKI, Chief Judge, COWEN,* and HAWKINS, Circuit Judges.

MEMORANDUM**

Vision Service Plan, Inc. ("VSP") appeals from the grant of summary judgment in favor of the United States on VSP's claim that it is a social welfare tax exempt organization pursuant to 26 U.S.C. § 501(c)(4).

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* The Honorable Robert E. Cowen, Senior United States Circuit Judge for the Third Circuit, sitting by designation.

** This disposition is not appropriate for publication and is not precedent except as provided by 9th Cir. R. 36-3.

VSP is not operated exclusively for the promotion of social welfare because it is not primarily engaged in promoting the common good and general welfare of the community. *See* 26 C.F.R. § 1.501(c)(4)-1(a)(2)(i) ("An organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community."). While VSP offers some public benefits, they are not enough for us to conclude that VSP is *primarily* engaged in promoting the common good and general welfare of the community. *See, e.g., Monterey Pub. Parking Corp. v. United States,* 481 F.2d 175, 177 (9th Cir. 1973) (noting that the district court made a quantitative comparison between the private and public benefits); *see also Comm'r v. Lake Forest, Inc.,* 305 F.2d 814, 818 (4th Cir. 1962) (noting that the public benefits of organization were too insubstantial to qualify the organization as exempt under Section 501(c)(4)); *Police Benevolent Ass'n of Richmond v. United States,* 661 F. Supp. 765, 772-73 (E.D. Va.), *aff'd,* 836 F.2d 547 (4th Cir. 1987) (per curiam) (unpublished opinion). Furthermore, VSP's own articles of incorporation state that the primary purpose of the corporation is to establish a fund from payments by subscribers to defray and assume the costs of vision care for those subscribers. This is a purpose that benefits VSP's subscribers rather than the general welfare of the community. *See Contracting Plumbers Co-op. Restoration Corp. v. United States,* 488 F.2d 684, 686-87 (2d Cir. 1973) (setting forth several factors to examine in deciding whether an

organization qualifies for a Section 501(c)(4) exemption, including the bylaws of the organization).

In light of the fact that VSP is not primarily engaged in promoting the general welfare under 26 C.F.R. § 1.501(c)(4)-1(a)(2)(i), we need not address whether VSP carries on its business with the public in a manner similar to those organizations operated for profit.

AFFIRMED.

United States District Court, E.D. California.
VISION SERVICE PLAN, Plaintiff,
v.
UNITED STATES OF AMERICA, Defendant.
No. CIV. S-04-1993 LKK/JFM.

Dec. 12, 2005.

ORDER

KARLTON, Senior J.

In 1960, Vison Service Plan ("VSP") was granted status as a tax-exempt organization. In 1999, the IRS commenced an examination of VSP. The IRS concluded that VSP was not entitled tax-exempt status under Internal Revenue Code, 26 U.S.C., ("IRC"), Section 501(c)(4). Def.'s SUF, 1. The IRS issued a final adverse determination letter to VSP, revoking its IRC Section 501(c)(4) status, effective prospectively from January 1, 2003. Def.'s SUF, 2. The following year, VSP paid the tax owed on its 2003 earnings, and then filed this suit.

Pending before the court are cross-motions for summary judgment. VSP seeks a determination that it is a social welfare organization under 501(c)(4), a refund of its income tax payment for 2003 and an order that the United States issue it a private letter recognizing VSP's status under 501(c)(4). The United States seeks summary judgment on the grounds that VSP does not qualify for exemption under 501(c)(4).

II.

STANDARDS

Summary judgment is appropriate when it is demonstrated that there exists no genuine issue as to any material fact, and that the moving party is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(c); *See also Adickes v. S.H. Kress & Co.*, 398 U.S. 144, 157 (1970); *Sicor Limited v. Cetus Corp.*, 51 F.3d 848, 853 (9th Cir. 1995).

Under summary judgment practice, the moving party

> [A]lways bears the initial responsibility of informing the district court of the basis for its motion, and identifying those portions of "the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any," which it believes demonstrate the absence of a genuine issue of material fact.

Celotex Corp. v. Catrett, 477 U.S. 317, 323 (1986). "[W]here the nonmoving party will bear the burden of proof at trial on a dispositive issue, a summary judgment motion may properly be made in reliance solely on the 'pleadings, depositions, answers to interrogatories, and admissions on file.'" *Id.* Indeed, summary judgment should be entered, after adequate time for discovery and upon motion, against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of

proof at trial. *See id.* at 322. "[A] complete failure of proof concerning an essential element of the nonmoving party's case necessarily renders all other facts immaterial." *Id.* In such a circumstance, summary judgment should be granted, "so long as whatever is before the district court demonstrates that the standard for entry of summary judgment, as set forth in Rule 56(c), is satisfied." *Id.* at 323.

If the moving party meets its initial responsibility, the burden then shifts to the opposing party to establish that a genuine issue as to any material fact actually does exist. *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 586 (1986); *See also First Nat'l Bank of Ariz. v. Cities Serv. Co.*, 391 U.S. 253, 288-89 (1968); *Sicor Limited*, 51 F.3d at 853.

In attempting to establish the existence of this factual dispute, the opposing party may not rely upon the denials of its pleadings, but is required to tender evidence of specific facts in the form of affidavits, and/or admissible discovery material, in support of its contention that the dispute exists. Fed. R. Civ. P. 56(e); *Matsushita*, 475 U.S. at 586 n. 11; *See also First Nat'l Bank*, 391 U.S. at 289; *Rand v. Rowland*, 154 F.3d 952, 954 (9th Cir. 1998). The opposing party must demonstrate that the fact in contention is material, i.e., a fact that might affect the outcome of the suit under the governing law, *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986); *Owens v. Local No. 169, Assoc. of Western Pulp and Paper Workers*, 971 F.2d 347, 355 (9th Cir. 1992) (quoting *T.W. Elec. Serv., Inc. v. Pacific Elec. Contractors Ass'n*, 809 F.2d

626, 630 (9th Cir. 1987), and that the dispute is genuine, i.e., the evidence is such that a reasonable jury could return a verdict for the nonmoving party, *Anderson,* 477 U.S. 248-49; *see also Cline v. Industrial Maintenance Engineering & Contracting Co.,* 200 F.3d 1223, 1228 (9th Cir. 1999).

In the endeavor to establish the existence of a factual dispute, the opposing party need not establish a material issue of fact conclusively in its favor. It is sufficient that "the claimed factual dispute be shown to require a jury or judge to resolve the parties' differing versions of the truth at trial." *First Nat'l Bank,* 391 U.S. at 290; *See also T.W. Elec. Serv.,* 809 F.2d at 631. Thus, the "purpose of summary judgment is to 'pierce the pleadings and to assess the proof in order to see whether there is a genuine need for trial.'" *Matsushita,* 475 U.S. at 587 (quoting Fed. R. Civ. P. 56(e) advisory committee's note on 1963 amendments); *see also International Union of Bricklayers & Allied Craftsman Local Union No. 20 v. Martin Jaska, Inc.,* 752 F.2d 1401, 1405 (9th Cir. 1985).

In resolving the summary judgment motion, the court examines the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any. Rule 56(c); *See also In re Citric Acid Litigation,* 191 F.3d 1090, 1093 (9th Cir. 1999). The evidence of the opposing party is to be believed, *see Anderson,* 477 U.S. at 255, and all reasonable inferences that may be drawn from the facts placed before the court must be drawn in favor of the opposing party, *see Matsushita,* 475 U.S. at 587 (citing

United States v. Diebold, Inc., 369 U.S. 654, 655 (1962) (*per curiam*)). Nevertheless, inferences are not drawn out of the air, and it is the opposing party's obligation to produce a factual predicate from which the inference may be drawn. *See Richards v. Nielsen Freight Lines*, 602 F. Supp. 1224, 1244-45 (E.D. Cal. 1985), *aff'd*, 810 F.2d 898, 902 (9th Cir. 1987).

Finally, to demonstrate a genuine issue, the opposing party "must do more than simply show that there is some metaphysical doubt as to the material facts. . . . Where the record taken as a whole could not lead a rational trier of fact to find for the nonmoving party, there is no 'genuine issue for trial.'" *Matsushita*, 475 U.S. at 587 (citation omitted).

III.

ANALYSIS

The issue to be resolved in the cross-motions is whether VSP qualifies for tax exempt status under 26 U.S.C. § 501(c)(4). Below, I explain why plaintiff's motion for summary judgment must be denied and defendant's motion for summary judgment must be granted.

A. APPLICABLE LAW[1]

A taxpayer seeking exemption from taxation has the burden of proving by clear and convincing proof that he is within a specific exemption clause. *Club Gaona, Inc. v. United States,* 167 F. Supp. 741, 746 (S.D. Cal. 1958).

Section 501(c)(4) of the Internal Revenue Code (26 U.S.C.A. § 501(c)(4)) provides federal tax exemption to a social welfare organization. Section 501 provides, in pertinent part, that "organizations not organized for profit but operated exclusively for the promotion of social welfare" shall be exempt from taxation. 26 U.S.C. §§ 501(a) and 501(c)(4)(A).

Although the words "exclusively" and "primarily" have different meanings, courts interpret the word "exclusively" to mean, "primarily." *See American Women Buyers Club, Inc. v. United States,* 338 F.2d 526, 528 (2nd Cir. 1964) ("The word 'exclusively' as used in the statute has not been given a strict interpretation . . . but rather has been interpreted to mean 'primarily.'") (citing *Debs Memorial Radio Fund, Inc. v. Commissioner,* 148 F.2d 948, 952 (2nd Cir. 1945)).

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[1] Because resolution of these motions require a fact-intensive inquiry, the court will eschew a separate exposition of the facts. The facts discussed during the analysis section are undisputed, unless indicated otherwise.

In like fashion, the regulations provide:

> An organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community. An organization embraced within this section is one which is operated primarily for the purpose of bringing about civic betterments and social improvements.

26 C.F.R. § 1.501(c)(4)-1(a)(2).

The regulations go on to provide that an organization is not operated primarily for the promotion of social welfare if its primary activity is "carrying on a business with the general public in a manner similar to organizations which are operated for profit." 26 C.F.R. § 1.501(c)(4)-1(a)(2)(ii).

In essence, VSP must establish that it is (1) not organized for profit; and (2) that it operates primarily for the promotion of social welfare. 26 C.F.R. § 1.501(c)(4)-1(a)(I) & (ii). As I explain below, VSP is unable to demonstrate satisfaction of either of the two requisite criteria.[2]

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[2] Defendant places great reliance of [sic] cases addressing qualification for tax exempt status under § 501(c)(3). That reliance is inapposite. Section 501(c)(3) and (c)(4) address different circumstances and have different criteria for exemption. Moreover, the three 503(c)(3) cases discussed by VSP are distinguishable as they involve actual health care providers or

(Continued on following page)

B. THE PROMOTION OF SOCIAL WELFARE

Plaintiff maintains that it qualifies for exemption under 501(c)(4) because "it is operated primarily for the promotion of social welfare." Pl.'s Mot. for Summ. J. at 2:20. VSP claims to serve broad segments of the community through direct services as well as through charity work. While VSP's charitable work is admirable, VSP cannot establish that it operates primarily for the promotion of social welfare within the meaning of the tax regulations.

The Treasury regulation provides that:

> An organization embraced within this section is one which is operated primarily for the purpose of bringing about civic betterments and social improvements.

26 C.F.R. § 1.501(c)(4)-1(a)(2).

Thus, to qualify an organization must be "a community movement designed to accomplish community ends." *Erie Endowment v. United States*, 316 F.2d 151, 156 (3d Cir. 1962).

It is frequently the case that an organization is found not to qualify under 501(c)(4) because it is operating primarily for the benefit of its members, rather than for the purpose of benefitting the community as a whole. *See, e.g., Contracting Plumbers*

HMOs. As discussed in the text, plaintiff is not a health care provider.

Co-op. Restoration Corp. v. United States, 488 F.2d 684, 686 (2d Cir. 1973) (plumbers cooperative not tax exempt as benefits were proportional to member's financial involvement); *American Women Buyers,* 338 F.2d at 528 (association not tax exempt as majority of benefits were for members and did not promote social welfare). In sum, where organizations provide substantially different benefits to the public as compared to its private members, it is not "primarily" devoted to social welfare as required by Section 501(c)(4). *Id.* at 687. In essence, even though there may be aspects of the organization that greatly benefit society, if the majority of the organization's services benefit private members, the organization cannot qualify for an exemption under 501(c)(4). Moreover, it has also been held that "[t]he presence of a single substantial non-exempt purpose precludes exempt status regardless of the number or importance of the exempt purpose." *Contracting Plumbers,* 588 F.2d at 686. Finally, it is pertinent to the instant case to note that the fact that an organization promotes health care, or is part of the health care industry, does not, alone, ensure exempt status within the tax code. *See IHC Health Plans Inc. v. Commissioner of Internal Revenue,* 325 F.3d 1188, 1197 (10th Cir. 2003).

The test for qualification under 501(c)(4) is stringent. For instance, in *Commissioner of Internal Revenue v. Lake Forest, Inc.,* 305 F.2d 814 (4th Cir. 1962), the court found that a membership-based organization involved in providing housing for veterans did not qualify. The court explained:

> Lake Forest does, of course, furnish housing to a certain group of citizens but it does not do so on a community basis. It is a public-spirited but privately-devoted endeavor. Its work in part incidentally redounds to society but this is not the 'social welfare' of the tax statute.

C.I.R. v. Lake Forest, Inc., 305 F.2d at 818. The court further explained that classification as "'civic' or 'social' depends upon the character – as public or private – of the benefits bestowed, of the beneficiary, and of the benefactor." *Id.*

As applied to the case at bar, the court concludes that despite VSP's charity work, the membership-based structure as well as the types of services offered, demonstrate that VSP's primary activity is not the promotion of social welfare. I begin this part of the analysis with an examination of VSP's service structure.

1. *VSP's Clients*

Plaintiff argues that VSP serves a broad cross section of the California community. *See* Pl.'s Mot. for Summ. J. at 27:12-16. While this may be true, VSP's primary activity is to defray and assume "the costs of professional vision care by establishing a fund from periodic payments by subscribers or beneficiaries, from which fund said costs may be paid." Decl. of Jeremy N. Hendon, Ex. A, VSP's Articles of Incorporation, at Article II. VSP contracts with employers,

health maintenance organizations, insurance companies, and political subdivisions ("subscribers") to arrange for the provision of vision care services and vision supplies to the subscribers' employees or members ("enrollees"). Def.'s SUF, 3.

VSP provides services to subscribers and through them, to enrollees. A non-enrolled individual may not simply walk in off the street to receive care. Def. SUF, 6. Although VSP does provide services through charity programs, these services to non-enrollees are not, comparatively, substantial. Much like the organizations at issue in *Lake Forest* or *Contracting Plumbers Cooperative,* the benefits that VSP provides to the public are incidental and not the primary purpose of VSP. VSP's primary purpose is to serve VSP's paying members.

VSP argues that there are several factors favoring a finding of tax exempt status. They note that (1) many of VSP's subscribers are small businesses, a consideration under the Internal Revenue Manual in evaluating tax exempt status, Pl.'s SUF 27; (2) many VSP doctors serve areas designated as medically needy or under served. Pl.'s SUF, 90-91.; (3) VSP provides vision care for many Medicaid and Medicare participants; and (4) VSP services low income children through the California Healthy Families Child Health Assistance Program ("Healthy Families"), Pl.'s SUF, 30. The court now addresses each of these contentions.

a. *Small Employers & Servicing Rural Areas*

Servicing small employers or rural subscribers and enrollees does not equate to promoting social welfare. *See* Def. Opp'n at 24: 14-22. Small employers or rural employers are still paying for VSP's services and VSP is making a profit from these contracts. VSP submits that the Internal Revenue Manual lists servicing smaller employers and rural enrollees as a factor in determining if an HMO qualifies for exemption under 501(c)(4). *See* Pl.'s Mot. for Summ. J. 27:20-22. This argument is unavailing. Even assuming arguendo the binding character of the manual, a dubious proposition, VSP is not an HMO, i.e. it does not provide medical services, it is instead what is known in the trade as a bundler.[3]

b. *Medicaid, Medicare and Healthy Families enrollees*

VSP argues that servicing Medicaid, Medicare and Healthy Families participants is a central part of how VSP promotes social welfare.

In 2003, VSP covered more than 2.1 million Medicaid and Medicare participants for vision care. These enrollees comprised 31.4% of VSP's total enrollment. Pl.'s SUF, 29. Combined with the children VSP served through Healthy Families, these three

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[3] There is nothing pejorative in the term, it simply notes a functional difference between providers, and an organization that arranges for the provision of services.

groups of enrollees represented 41.5% of VSP's total enrollment in 2003. VSP submits that it suffered substantial losses from providing services to Medicaid, Medicare and Healthy Families participants. *See* Pl.'s SUF, 35. VSP argues that these facts support a finding that VSP is primarily engaged in promoting social welfare. The court cannot agree.

First, VSP competitively bid for the Medicaid, Medicare and Healthy Families contracts. *See* Def.'s Mot. for Summ. J., Hendon Dec., Ex. H at 137-41. As defendant notes:

> The criterion for an Enrollee to receive VSP's services is not whether such person is a member of a medically underserved population. Rather, the criterion is whether the Enrollee is an employee or member of a paying Subscriber (e.g., the State of California) which contracts with VSP for a fee. That is, VSP does not focus on individuals who need medical care, but focuses on its Subscribers with whom VSP contracts for a fee.

Def. Mot. for Summ. J. at 11:15-19.

Second, in calculating the alleged losses, VSP includes discounts given by participant doctors. This does not appear appropriate. As the court understands it, the providing doctor incurs the loss and not VSP.[4] Therefore, the court does not accept as accurate

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[4] Defendant's example is helpful in understanding how it is that VSP does not absorb the loss:

(Continued on following page)

the alleged "losses" as calculated by plaintiff. *See* Pl. Mot. for Summ. J., Cochran Dec., Ex. K.

Third, from all that appears, the Medicaid, Medicare and Healthy Families programs are profitable for VSP. As defendant maintains, if VSP refused to reduce its fees for these contracts, "VSP would lose a substantial volume of business, albeit at reduced fees." Def.'s Opp'n to Pl. Mot. for Summ. J. at 27:23-26.

Fourth, VSP claims that in 2003, excluding doctor discounts, VSP spent $4,296,055.00 on discounts and underwritten losses for Medicare, Medicaid and Healthy Families participants. Pl's. Mot. for Summ. J., Cochran Dec. Ex. N. Even if the court accepts VSP's numbers as accurate, this expenditure of $4,296,055.00 is a relatively small fraction of VSP's net income for 2003, which was $34,487,626.00, *id.*, and an even smaller fraction of VSP's gross income

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> For example, suppose the customary doctor fee was $100 per patient and the reduced doctor fee for Subscribers with Medicare enrollees was $75 per patient; VSP does not suffer a $25 loss because, while it receives $75 per patient from the Subscriber, it is required to pay the doctor provider only $75 per patient, not $100. Thus, there is no net "loss" to VSP. The doctor is the only participant who arguably suffers a "loss."

Def. Opp'n at 27:15-19.

Moreover, even there the "loss" suffered by the provider is only as compared to his usual fee.

for 2003, which was $425 million. Def.'s Mot. for Summ. J., Hendon Dec., Ex. K.

Even if the court concluded that servicing these specific enrollees could constitute promoting social welfare, these enrollees make up less than half of VSP's total enrollment, thus again negating a conclusion that VSP is "primarily engaged" (much less exclusively engaged) in promoting social welfare.

While VSP does in fact offer services to these groups, it is also very clear that servicing these particular enrollees is not VSP's primary activity. Put directly, VSP is operating primarily for the benefit of its subscribers rather than for the purpose of benefitting the community as a whole. This conclusion precludes VSP from exemption under 501(c)(4). *See, e.g., Contracting Plumbers,* 488 F.2d at 686; *American Women Buyers Club,* 338 F.2d at 528.

2. *VSP's Charity Services*

Plaintiff maintains that VSP provides free vision care to "substantial numbers of non-enrollees under VSP's charity programs." Pl.'s SUF, 23. It is true that VSP provides vision care services to non-enrollees. Nonetheless, the provision of these services is comparatively small, and again, does not establish that VSP is primarily engaged in promoting social welfare.

There are two main programs through which non-enrollees might receive vision care services: the Sight for Students program and disaster relief efforts.

a. *Sight for Students*

This program targets children of families earning up to 200% of the poverty level and who do not participate in other eyecare insurance programs. VSP's free services under the program include eye examinations, eyeglasses, medically-necessary contact lenses, vision therapy and low vision treatment. These services are available for students up to age 18 or through graduation from high school. Pl.'s SUF, 37. The Sight for Students children and their families select a VSP doctor and present a VSP service authorization (voucher). The VSP doctor then provides services and is paid standard VSP contract rates by VSP or a local VSP affiliate. VSP or an affiliate bears the cost of the providers' services and of the glasses or contacts provided under the plan. Pl.'s SUF, 39.

In 2003, VSP spent $2.8 million dollars on this program, Pl.'s Mot. for Summ. J., Cochran Dec., Ex. N, and provided services for 12,558 children. *Id.*, Ex. H. When one compares $2.8 million, however, with VSP's net or gross income, it appears that the amount spent on this program is not substantial. Indeed, children receiving care under the Sight for Students program constituted only .19% of VSP's total enrollment. Taken together, these facts support a finding that VSP is not primarily engaged in the promotion of social welfare.

b. *Disaster Relief Services*

In conjunction with the American Red Cross, VSP also contributes to disaster relief by providing free exams and replacement glasses to disaster victims. VSP provides vouchers to chapters of the American Red Cross for free services. Disaster victims may present these authorizations to VSP providers to receive free examinations and glasses, for which VSP reimburses the providers. Pl.'s SUF, 41.

In 2003, VSP provided services for 285 people compared to a total enrollment of 6 million, Pl.'s Mot. for Summ. J., Cochran Dec., Ex. H, and spent roughly $73,132.00. *Id.* Again, compared to either VSP's net income or gross income, the amount spent on disaster relief services is minimal.

3. *VSP's Community Outreach and Community Education*

In addition to providing services to non-enrollees, VSP also engages in educational and community outreach. These programs include: (1) Get Focused Campaign; (2) Health Care Vision Project; (3) Vision USA; (4) Eye on Health Patient Newsletter; (5) Optometric Education and Research; (6) Clinical Guidelines and Algorithms; and (7) Paid Time Off for Volunteer Service. See Pl.'s Mot. for Summ. J. at 34-36. VSP claims that these programs, in conjunction with the services provided to Medicaid, Medicare and Healthy Families participants, support a finding that

it is primarily engaged in the promotion of social welfare. The court cannot agree.

While these programs are admirable and important, they do not demonstrate VSP being primarily involved in the promotion of social welfare. In 2003, VSP spent $3,893,496.00 on these programs. *See* Pl.'s Mot. for Summ. J., Cochran Dec., Ex N. This includes the Sight for Students Program, as well as disaster relief services. Again, this is a very small fraction of VSP's gross or net income for 2003.

Plaintiff submits that, taken together, VSP's charity work and service to Medicaid, Medicare and Healthy Families participants demonstrates that VSP should be exempt under the requirements of 501(c)(4). VSP's own numbers do not support such a conclusion.

In 2003, VSP spent roughly 8 million dollars on charity work. *See* Pl.'d Mot. for Summ. J., Cochran Decl., Ex. N. This number does not include doctor discounts, but does include the costs that VSP allegedly incurred providing services to Medicaid, Medicare and Healthy Families participants.

Even assuming that VPS's calculations are accurate, eight million dollars is 24% of VSP's 2003 net income and an even smaller percentage of VSP's gross income. In sum, these programs and services do not demonstrate that VSP is primarily engaged in the promotion of social welfare. While VSP does contribute to the betterment of society, like the organization in *Lake Forest,* it is a "publicly spirited but

privately-devoted endeavor." *Lake Forest,* 305 F.2d at 818. VSP's work "incidentally redounds to society but this is not the 'social welfare' of the tax statute." *Id.*

Put directly, the court must conclude that VSP's services are most beneficial to private paying members, the subscribers and the enrollees. Like the members of the plumbers cooperation in *Contracting Plumbers,* members of VSP enjoy the benefit of VSP's services precisely to the extent that members use and pay for the services. *Contracting Plumbers,* 488 F.2d at 687. Serving the interests of these private subscribers is clearly a non-exempt purpose. *Id.* This non-exempt purpose destroys VSP's exemption status, regardless of the number or importance of truly exempt purposes. *Id.*; *American Women Buying Club,* 338 F.2d at 528.

C. NOT OPERATING FOR PROFIT

Plaintiff submits that VSP was organized as a non-profit and operates like one. VSP points to its by-laws, which provides in pertinent part:

> This Corporation shall operate as a nonprofit corporation and shall be organized and operated exclusively for the promotion of social welfare within the meaning of Section 501(c)(4) of the Internal Revenue Code of 1986, as amended, or any successor provision. The Corporation shall maintain and operate a voluntary nonprofit vision care plan to provide care to subscribers to such plan under contracts which entitle the subscribers

> to certain eye care; to provide eye care to medically underserved persons, whether or not subscribers to such plan; to provide public education regarding vision and vision care; to perform such services in a manner that benefits the community; and to engage in any and all lawful activities necessary and incidental thereto.

Pl.'s SUF, 3.

The issue, however, is not whether plaintiff is a nonprofit corporation for corporation law purposes, but whether it is one for federal tax purposes.

To qualify for an exemption under 501(c)(4), an organization must establish that it operates exclusively for the promotion of social welfare. According to the Treasury regulations, an organization is not operated primarily for the promotion of social welfare if its primary activity is "carrying on a business with the general public in a manner similar to organizations which are operated for profit." 26 C.F.R. § 1.501(c)(4)-1(a)(2)(ii). Moreover, a corporation that devotes much of its revenues to improving its ability to compete commercially through accumulation of large surpluses and expansion of its income producing facilities is not entitled to exemption under Section 501(c)(4). *People's Educational Camp Soc. Inc. v. C.I.R.*, 331 F.2d 923, 932 (2d Cir. 1964).

In this regard, I begin by noting that VSP engages in cost-cutting measures common to for-profit businesses. For example, a portion of VSP's bonus

structure paid to its employees is directly tied to reducing VSP's costs. Def.'s SUF, 24. *See also* Def.'s SUF, 25 and 26 (discussing other ways that VSP cuts costs).

Second, VSP strives to remain competitive in ways that do not appear to be consistent with the operations of a non-profit. For example, VSP pays commissions to brokers who bring new clients. In 2003, VSP paid $19 million in broker commissions. (This is more than VSP spent on charity work in 2003, Pl.'s Mot. for Summ. J., Cochran Dec., Ex. N). The broker's commission is calculated based on the revenue that VSP receives from each new client. Def.'s SUF, 29. *See also* Def.'s SUF, 30-31.

Moreover, the court is unable to agree with plaintiff that no one profits from its activities. Although VSP's by-laws provide that VSP has no equity owners who are entitled to share in its net earnings, in fact VSP executives and officers receive bonuses that are taken directly from the net earnings. *See* Def.'s Resp. to Pl.'s SUF, 4 (discussing VSP executive bonuses and how bonuses are calculated). Furthermore, VSP offers its executives high salaries and other forms of compensation that are more consistent with a for-profit corporation than an [sic] non-profit. For example, Roger Valine, the Chief Executive Officer of VSP, although not required to work full time, was paid a $395,000 base salary for 2003, in addition to a sizable bonus plan. Def.'s SUF, 37 & 44. Chief officers and executives are also provided with luxury company cars. *See* Def.'s SUF, 47-49. VSP

specifically targeted the executives' salaries to median market levels, making no distinction between salaries paid to executives working at for-profit businesses, and executives working at non-profit entities. Def.'s SUF, 38. *See also* Def.'s SUF, 40-41; 47-49 (describes other ways that executives are compensated).

The court concludes that VSP carries on business with the public "in a manner similar to organizations which are operated for profit." 26 C.F.R. § 1.501(c)(4)-1(a)(2)(ii). Therefore, VSP does not operate primarily for the promotion of social welfare.

D. CONCLUSION

Plaintiff has failed to establish that it qualifies for exempt status under 501(c)(4). VSP is not operated "exclusively for the promotion of social welfare" as provided for in 501(c)(4). For these reasons, summary judgment for the defendant, United States, is GRANTED. Summary judgment for the plaintiff, VSP, is DENIED. The Clerk is directed to ENTER judgment accordingly and CLOSE the case.

IT IS SO ORDERED.

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

VISION SERVICE PLAN, INC., Plaintiff-Appellant, v. UNITED STATES OF AMERICA, Defendant-Appellee.	No. 06-15269 D.C. No. CV-04-01993-LKK Eastern District of California, Sacramento ORDER (Filed Apr. 9, 2008)

Before: KOZINSKI, Chief Judge, COWEN,* and HAWKINS, Circuit Judges.

The panel has voted to deny the petition for rehearing. Chief Judge Kozinski and Judge Hawkins have voted to deny the petition for rehearing en banc. Judge Cowen has recommended denying the en banc petition.

The full court has been advised of the petition for rehearing en banc and no Judge has requested a vote on whether to rehear the matter en banc. Fed. R. App. P. 35.

The petition for rehearing and petition for rehearing en banc are DENIED.

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* The Honorable Robert E. Cowen, Senior United States Circuit Judge for the Third Circuit, sitting by designation.

26 U.S.C. §§ 501(a), 501(c)(3)-(4), and 501(m)

(a) Exemption from taxation. – An organization described in subsection (c) or (d) or section 401(a) shall be exempt from taxation under this subtitle unless such exemption is denied under section 502 or 503

. . .

(c) List of exempt organizations. – The following organizations are referred to in subsection (a):

. . .

(3) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

(4)(A) Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.

(B) Subparagraph (A) shall not apply to an entity unless no part of the net earnings of such entity inures to the benefit of any private shareholder or individual.

. . .

(m) Certain organizations providing commercial-type insurance not exempt from tax. –

(1) Denial of tax exemption where providing commercial-type insurance is substantial part of activities. – An organization described in paragraph (3) or (4) of subsection (c) shall be exempt from tax under subsection (a) only if no substantial part of its activities consists of providing commercial-type insurance.

(2) Other organizations taxed as insurance companies on insurance business. – In the case of an organization described in paragraph (3) or (4) of subsection (c) which is exempt from tax under subsection (a) after the application of paragraph (1) of this subsection –

(A) the activity of providing commercial-type insurance shall be treated as an unrelated trade or business (as defined in section 513), and

(B) in lieu of the tax imposed by section 511 with respect to such activity, such organization shall be treated as an insurance company for purposes of applying subchapter L with respect to such activity.

(3) Commercial-type insurance. – For purposes of this subsection, the term "commercial-type insurance" shall not include –

(A) insurance provided at substantially below cost to a class of charitable recipients,

(B) incidental health insurance provided by a health maintenance organization of a kind customarily provided by such organizations,

(C) property or casualty insurance provided (directly or through an organization described in section 414(e)(3)(B)(ii)) by a church or convention or association of churches for such church or convention or association of churches,

(D) providing retirement or welfare benefits (or both) by a church or a convention or association of churches (directly or through an organization described in section 414(e)(3)(A) or 414(e)(3)(B)(ii)) for the employees (including employees described in section 414(e)(3)(B)) of such church or convention or association of churches or the beneficiaries of such employees, and

(E) charitable gift annuities.

(4) Insurance includes annuities. – For purposes of this subsection, the issuance of annuity contracts shall be treated as providing insurance.

(5) Charitable gift annuity. – For purposes of paragraph (3)(E), the term "charitable gift annuity" means an annuity if –

(A) a portion of the amount paid in connection with the issuance of the annuity is allowable as a deduction under section 170 or 2055, and

(B) the annuity is described in section 514(c)(5) (determined as if any amount paid in cash in connection with such issuance were property).

Treasury Regulation § 1.501(c)(4)(1)

(a) Civic organizations – (1) In general. A civic league or organization may be exempt as an organization described in section 501(c)(4) if –

(i) It is not organized or operated for profit; and

(ii) It is operated exclusively for the promotion of social welfare.

(2) Promotion of social welfare – (i) In general. An organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community. An organization embraced within this section is one which is operated primarily for

the purpose of bringing about civic betterments and social improvements. A social welfare organization will qualify for exemption as a charitable organization if it falls within the definition of charitable set forth in paragraph (d)(2) of § 1.501(c)(3)-1 and is not an action organization as set forth in paragraph (c)(3) of § 1.501(c)(3)-1.

(ii) Political or social activities. The promotion of social welfare does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office. Nor is an organization operated primarily for the promotion of social welfare if its primary activity is operating a social club for the benefit, pleasure, or recreation of its members, or is carrying on a business with the general public in a manner similar to organizations which are operated for profit. See, however, section 501(c)(6) and § 1.501(c)(6)-1, relating to business leagues and similar organizations. A social welfare organization that is not, at any time after October 4, 1976, exempt from taxation as an organization described in section 501(c)(3) may qualify under section 501(c)(4) even though it is an action organization described in § 1.501(c)(3)-1(c)(3)(ii) or (iv), if it otherwise qualifies under this section. For rules relating to an organization that is, after October 4, 1976, exempt from taxation as an organization described in section 501(c)(3), see section 504 and § 1.504-1.

(b) Local associations of employees. Local associations of employees described in section 501(c)(4) are expressly entitled to exemption under section 501(a). As conditions to exemption, it is

required (1) that the membership of such an association be limited to the employees of a designated person or persons in a particular municipality, and (2) that the net earnings of the association be devoted exclusively to charitable, educational, or recreational purposes. The word local is defined in paragraph (b) of § 1.501(c)(12)-1. See paragraph (d)(2) and (3) of § 1.501(c)(3)-1 with reference to the meaning of charitable and educational as used in this section.

Supreme Court, U.S.
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No. 08-164

In the Supreme Court of the United States

VISION SERVICE PLAN, INC., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether petitioner qualifies for exemption from federal income tax as a "social welfare" organization within the meaning of 26 U.S.C. 501(c)(4).

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-3a) is not published in the *Federal Reporter* but is reprinted in 265 Fed. Appx. 650. The opinion of the district court (Pet. App. 4a-25a) is not published in the *Federal Supplement* but is reprinted in 2006-1 U.S. Tax Cas. (CCH) ¶ 50,173.

JURISDICTION

The judgment of the court of appeals was entered on January 30, 2008. A petition for rehearing was denied on April 9, 2008 (Pet. App. 26a). On June 19, 2008, Justice Kennedy extended the time within which to file a petition for a writ of certiorari to and including August 7, 2008, and the petition was filed on that date. The ju-

risdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Section 501(a) of the Internal Revenue Code exempts from federal income taxation certain organizations, including those described in Section 501(c)(4), *i.e.*, organizations "not organized for profit but operated exclusively for the promotion of social welfare." 26 U.S.C. 501(a) and (c)(4)(A). Under Treasury regulations implementing Section 501(c)(4), an organization is operated exclusively for the promotion of social welfare "if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community." 26 C.F.R. 1.501(c)(4)-1(a)(2)(i). An organization is not operated primarily for the promotion of social welfare, however, if "its primary activity is * * * carrying on a business with the general public in a manner similar to organizations which are operated for profit." 26 C.F.R. 1.501(c)(4)-1(a)(2)(ii).

2. According to petitioner's articles of incorporation, its purpose is to "defray and assume the costs of professional vision care, by establishing a fund from periodic payments by subscribers or beneficiaries, from which fund said costs may be paid." S.E.R. 17. Petitioner's primary activity consists of contracting with employers, health maintenance organizations (HMOs), insurance companies, and political subdivisions (collectively, subscribers) to arrange for the provision of vision-care services and vision supplies to subscribers' employees or members (collectively, enrollees). E.R. 5; S.E.R. 24-25. Petitioner arranges for those vision-care services and supplies, which generally include an eye examination and a prescription for lenses, to be provided to enrollees

by independent vision-care professionals (participating providers) such as optometrists. S.E.R. 25-26. Petitioner itself, however, does not employ any providers or directly deliver vision services. Pet. App. 15a; S.E.R. 162-163.

Petitioner operates a prepaid vision-care program and a self-funded program, both of which require subscribers to pay an administrative fee. S.E.R. 42-44. Under the prepaid program, the subscriber agrees to pay a fixed monthly amount to petitioner, in return for which the subscriber's enrollees are entitled to receive certain contracted-for vision-care benefits from petitioner's participating providers. S.E.R. 42-43. Under the self-funded program, also known as the Administrative Service Plan, petitioner provides administrative services, such as processing and paying claims, in exchange for an administrative fee. Petitioner ultimately receives reimbursement from the subscriber, however, for any claim that is incurred by the subscriber's enrollee. S.E.R. 43; E.R. 4-5.

Most of petitioner's enrollees are employed by its large subscribers, each of whom has 1000 or more employees. E.R. 54. Members of the general public cannot receive petitioner's services without being an employee or member of an employer, political subdivision, or other group under contract with petitioner. S.E.R. 24-25, 33-34. Unenrolled individuals therefore are not eligible for petitioner's services and may not receive vision-care benefits. Pet. App. 14a.

During the year 2003, petitioner's primary sources of revenue consisted of (1) administrative fees received from Administrative Service Plan subscribers, (2) prepaid vision-care charges received from contracted subscribers, and (3) interest and dividends earned on its

investment portfolio. S.E.R. 88-89. Petitioner's gross income for 2003 was $425 million (Pet. App. 18a), and its net income was $34,487,626 (*id.* at 17a). As reported on its federal income tax return, petitioner's accumulated surplus at the end of 2003 exceeded $300 million. S.E.R. 96, line 26.

Petitioner contends that its activities benefit the public in several ways. Petitioner contracts with small and rural employers who pay for petitioner's services. Pet. App. 15a. Petitioner also arranges or administers vision-care services for participants in Medicare, Medicaid, and the California Healthy Families Child Health Assistance Program (Healthy Families). *Id.* at 15a; E.R. 6. In 2003, the participants in those programs comprised approximately 41.5% of petitioner's total enrollment, and petitioner claims to have "spent $4,296,055.00 on discounts and underwritten losses" on those programs during that year. Pet. App. 15a-17a. In addition, petitioner arranges for free vision services to nonenrollees, chiefly under its Sight for Students and disaster-relief programs. *Id.* at 19a. In 2003, petitioner spent $2.8 million on services to 12,558 low-income children under Sight for Students, *ibid.*, and it provided $73,132 in disaster relief for 285 people, *ibid.* Petitioner also spent $3,893,496 on community-outreach and community-education programs in 2003. *Id.* at 21a.

Petitioner operates two for-profit laboratories that fabricate eyeglass lenses for its participating providers. S.E.R. 20-21. It also contracts with other laboratories around the United States to provide the same services. S.E.R. 20. Petitioner requires its participating providers to use its approved laboratories, including its two for-profit laboratories, when filling eyeglass prescriptions. *Ibid.* Petitioner also wholly owns a subsidiary

for-profit frame manufacturing and distribution company, Altair Eyewear, which provides frames to petitioner's participating providers. S.E.R. 53-57. During 2003, petitioner required 526 participating providers to sell frames made by its for-profit Altair Eyewear subsidiary. S.E.R. 85.

3. In 1960, petitioner was granted an exemption from federal income tax as a social welfare organization described in 26 U.S.C. 501(c)(4). Pet. App. 4a. In 1999, the Internal Revenue Service (IRS) began an examination of petitioner and ultimately concluded that, effective January 1, 2003, petitioner would no longer receive tax-exempt status under Section 501(c)(4). *Ibid.*

Petitioner filed an income tax return on its 2003 earnings, reporting and paying a tax of more than $7 million. Pet. App. 4a; S.E.R. 90. Petitioner subsequently filed an amended return requesting a refund, contending that it qualifies as a tax-exempt "social welfare" organization under Section 501(c)(4). After the IRS did not act on the refund claim during the ensuing six-month period, petitioner brought this suit for refund. Pet. App. 4a; E.R. 13.

4. The district court granted summary judgment to the government. Pet. App. 4a-25a. The court observed that, to be considered a social welfare organization under Section 501(c)(4), an entity must be "primarily engaged in promoting in some way the common good and general welfare of the people of the community," *id.* at 10a (quoting 26 C.F.R. 1.501(c)(4)-1(a)(2)(i)), rather than "carrying on a business with the general public in a manner similar to organizations which are operated for profit," *ibid.* (quoting 26 C.F.R. 1.501(c)(4)-1(a)(2)(ii)). The court concluded that petitioner's bid for an exemp-

tion did not satisfy "either of the two requisite criteria." *Ibid.*

a. The district court held that petitioner's "primary activity is not the promotion of social welfare." Pet. App. 13a; see *id.* at 11a-22a. The court observed that petitioner does not offer its vision-care plans to the general public; rather, its services are available only to employees or members of a subscribing employer, political subdivision, or other group with which petitioner has contracted. *Id.* at 13a-14a. Although the court acknowledged that petitioner "does provide services through charity programs," it found that "th[o]se services to non-enrollees are not, comparatively, substantial." *Id.* at 14a. The court explained that the $8 million petitioner spent on charitable activities amounted to only "24% of [petitioner's] 2003 net income [of $34.4 million] and an even smaller percentage of [petitioner's] gross income [of $425 million]." *Id.* at 21a. The district court therefore concluded that petitioner was not "primarily engaged in the promotion of social welfare," *ibid.*, but instead provided public benefits that were "incidental" to the "primary purpose" of "serv[ing] [petitioner's] paying members," *id.* at 14a.

b. In the alternative, the district court held that petitioner was carrying on a business with the public in a manner similar to that of for-profit organizations and was therefore disqualified from tax-exempt status under 26 C.F.R. 1.501(c)(4)-1(a)(2)(ii). Pet. App. 22a-25a. The court explained that an organization is not entitled to exemption under Section 501(c)(4) if it "devotes much of its revenues to improving its ability to compete commercially through accumulation of large surpluses and expansion of its income producing facilities." *Id.* at 23a. The court observed that, by tying bonuses to cost reduc-

tions, petitioner resembles a for-profit business. *Id.* at 23a-24a. It noted as well that petitioner "strives to remain competitive in ways that do not appear to be consistent with the operations of a non-profit," such as by paying commissions to brokers for new clients. *Id.* at 24a. The court also found it significant that bonuses paid by petitioner are "taken directly from the net earnings," and that petitioner's executives are compensated in a manner "more consistent with a for-profit corporation than [a] non-profit." *Ibid.*

5. The court of appeals affirmed in an unpublished per curiam opinion. Pet. App. 1a-3a. The court held that petitioner is not entitled to tax-exempt status because "it is not primarily engaged in promoting the common good and general welfare of the community." *Id.* at 2a. The court also observed that petitioner's own articles of incorporation state that "the primary purpose of the corporation is to establish a fund from payments by subscribers to defray and assume the costs of vision care for those subscribers." *Ibid.* The court stated that "[t]his is a purpose that benefits [petitioner's] subscribers rather than the general welfare of the community." *Ibid.* In light of that conclusion, the court of appeals did not address the district court's alternative holding that petitioner "carries on its business with the public in a manner similar to those organizations operated for profit." *Ibid.*

ARGUMENT

Petitioner contends that it qualifies as a tax-exempt "social welfare" organization within the meaning of 26 U.S.C. 501(c)(4). The court of appeals correctly rejected that argument, and its ruling (as petitioner acknowledges, see Pet. 6) does not conflict with the decision of

any other court of appeals. Further review is not warranted.

1. The courts below correctly concluded (Pet. App. 2a-3a, 11a-22a) that petitioner was not "operated exclusively for the promotion of social welfare" within the meaning of 26 U.S.C. 501(c)(4)(A) so as to qualify for a tax exemption under 26 U.S.C. 501(a). For this purpose, "exclusively" has been interpreted to mean "primarily." See 26 C.F.R. 1.501(c)(4)-1(a)(2)(i) (requiring that the organization be "primarily engaged in promoting in some way the common good and general welfare of the people of the community"); *American Women Buyers Club, Inc.* v. *United States*, 338 F.2d 526, 528 (2d Cir. 1964). Under that standard, a single nonexempt purpose, if substantial in nature, renders an organization ineligible for tax-exempt status. See *Better Business Bureau, Inc.* v. *United States*, 326 U.S. 279, 283 (1945); *Contracting Plumbers Coop. Restoration Corp.* v. *United States*, 488 F.2d 684, 686 (2d Cir. 1973), cert. denied, 419 U.S. 827 (1974); *American Women Buyers Club*, 338 F.2d at 528; *Commissioner* v. *Lake Forest, Inc.*, 305 F.2d 814, 820 (4th Cir. 1962).

An organization that operates primarily for the benefit of its members, rather than for the benefit of the community as a whole, is not exempt from tax under Section 501(c)(4). In applying that standard, a central consideration is whether the organization places barriers to membership by the public at large. For example, in *American Women Buyers Club*, the Second Circuit held that a membership organization consisting of a restricted group of female buyers of ready-to-wear-apparel was not exempt from tax, even though one of the organization's stated purposes was to promote the welfare of ready-to-wear buyers throughout the country.

338 F.2d at 527. The court explained that, as a practical matter, most of the benefits that the organization provided were for members only. *Id.* at 528.

Similarly in *Lake Forest*, the Fourth Circuit held that a membership-based nonprofit corporation that provided housing primarily for war veterans did not qualify for exempt status under Section 501(c)(4). The court noted that, although the term "social welfare" may be defined as "the well-being of persons as a community," the organization there did "not propose to offer a service or program for the direct betterment or improvement of the community as a whole." *Lake Forest*, 305 F.2d at 818. The court further explained that, although the development's playground, parks, library, and meeting halls were open to the general public, such access was not recognized "by way of dedication," but was "more through sufferance than by grant." *Ibid.* The court concluded that "[w]hatever the nature of the rights or privileges thus afforded persons other than members, it is a circumstance too insubstantial to qualify the entire activity of the corporation as in the social welfare." *Ibid.*

Likewise in *Contracting Plumbers*, the Second Circuit denied an exemption under Section 501(c)(4) to a plumbers' cooperative organized to repair damage to city streets caused by the members' activities. The court found it significant that "each member of the cooperative enjoys th[o]se economic benefits *precisely* to the extent that he uses, and pays for, its restoration services." 488 F.2d at 687. The court concluded that, because the organization provided "substantial and different benefits to both the public and its private members," it was not "'primarily' devoted to the common good as

required by even the most liberal reading of § 501(c)(4)." *Ibid.*

Thus, under longstanding precedents interpreting Section 501(c)(4), an organization's "[c]lassification as 'civic' or 'social' depends upon the character—as public or private—of the benefits bestowed, of the beneficiary, and of the benefactor." *Lake Forest*, 305 F.2d at 818. Consistent with that understanding, the courts below correctly rejected petitioner's claim to an exemption. Petitioner's operations are primarily oriented toward its private subscribers rather than toward the general public. Petitioner does not arrange or administer vision plans for the benefit of the community as a whole or even offer its plans to the general public. Instead, it contracts only with certain employers, health maintenance organizations, insurance companies, and political subdivisions. Pet. App. 13a-14a; E.R. 270. Contrary to petitioner's assertions (Pet. 4, 7, 10), the sheer number of its enrollees does not mean that it is primarily community-oriented. As the Fourth Circuit observed in *Lake Forest*, "[s]ize of membership in ratio to local population is not controlling on whether an organization is 'civic' or 'social.' The number affected is not the criterion." 305 F.2d at 816.

The fundamentally private character of petitioner's operations is manifested by several aspects of its operations. Rather than being primarily oriented toward the welfare of the community as a whole, petitioner arranges or administers plans primarily for the benefit of a narrow subset of the community, *i.e.*, the individuals, working for companies employing 1000 or more, who are a majority of its enrollees. E.R. 54. A member of the general public cannot receive benefits from petitioner unless he is an enrollee of a paying subscriber (be it an

employer, Medicare, Medicaid, or Healthy Families) or falls into the de minimis group to whom petitioner offers charitable benefits. S.E.R. 24-25, 33-34. As the district court observed, "[a] non-enrolled individual may not simply walk in off the street to receive care"; rather, petitioner's "primary purpose is to serve [its] paying members." Pet. App. 14a.

In addition, petitioner requires its participating providers (from whom its enrollees must choose) to use only approved laboratories, including its own two for-profit laboratories, when filling lens prescriptions. S.E.R. 20. In 2003, petitioner required 526 providers to sell frames made by its for-profit subsidiary. S.E.R. 50, 53-57, 85. Petitioner's governing board is controlled by representatives of its participating providers, who benefit economically from the customers directed to them by petitioner's plans. E.R. 3. Rather than primarily promoting the common good and general welfare of the community as a whole, petitioner is conducting a "privately-devoted endeavor." *Lake Forest*, 305 F.2d at 818.[1]

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[1] Also misconceived is the argument of petitioner (Pet. 22-25), joined by amici National Taxpayers Union (Br. 4-5, 10), Prevent Blindness America, et al. (Br. 6, 18-19), and Darryll K. Jones (Br. 6-7), that the denial of exempt status for petitioner's membership-based organization is inconsistent with public policy and places the exemptions of tax-exempt HMOs at risk. The determination of tax-exempt status under Section 501(c)(4) is based on an analysis of the facts and circumstances of each particular case. See, *e.g.*, *Lake Forest*, 305 F.2d at 816-820. Here, the courts below correctly concluded that private interests (those of the enrollees and subscribers) benefitted to such a degree that petitioner is not operating primarily to promote social welfare. Pet. App. 2a, 14a, 22a. That ruling was based on close examination of petitioner's own operations and will not, as petitioner contends (Pet. 24-25), jeopardize the tax-exempt status of all HMOs.

2. The district court correctly held (Pet. App. 22a-25a) that petitioner also fails to satisfy the second requirement for exempt status—namely, that it "not [be] organized for profit," 26 U.S.C. 501(c)(4)—because petitioner's primary activity is "carrying on a business with the general public in a manner similar to organizations which are operated for profit." 26 C.F.R. 1.501(c)(4)-1(a)(2)(ii); see *People's Educ. Camp Soc'y, Inc.* v. *Commissioner*, 331 F.2d 923, 932 & n.11 (2d Cir.), cert. denied, 379 U.S. 839 (1964). Although the court of appeals did not address that issue (Pet. App. 3a), the existence of that alternative ground for affirmance provides a further reason to deny review.

As explained above, petitioner's primary activity is to arrange vision-care services by connecting its paying subscribers and their enrollees to petitioner's participating providers. Such conduct constitutes ordinary commercial activity. Moreover, as the district court concluded (Pet. App. 24a-25a), petitioner conducts its operations in a manner typical of a for-profit company by paying its executives high salaries and bonuses tied to cost containment, eliminating unprofitable programs, making planned reductions in spending for charitable programs, and basing broker commissions on the revenues received from new clients. S.E.R. 51-52, 64-68, 70-73, 98, 107-112, 132, 136-138, 155-156. Indeed, petitioner had accumulated a surplus of more than $300 million by the end of 2003. S.E.R. 96.[2] Under those circumstances, as the district court correctly recognized (Pet. App. 22a-25a), a grant of tax-exempt status would give petitioner an

[2] Although petitioner asserts (Pet. 6) that it uses its accumulated surplus to improve the cost-effectiveness and quality of the vision-care services it provides, it fails to provide record references for that contention, and the record belies any such claim.

unfair competitive advantage over for-profit entities that operate their businesses in a similar manner.

3. Petitioner's assertion (Pet. 12-13) that it is a charitable entity under the common law of charitable trusts is unfounded. That issue was neither raised before nor addressed by the court of appeals, and this Court should therefore decline to consider it. See *Adickes* v. *S.H. Kress & Co.*, 398 U.S. 144, 147 n.2 (1970).

In any event, petitioner is wrong in contending (Pet. 11) that the promotion of health, standing alone, is an exempt purpose. Indeed, many for-profit entities promote health. See *IHC Health Plans, Inc.* v. *Commissioner*, 325 F.3d 1188, 1197 (10th Cir. 2003); *Federation Pharmacy Servs. Inc.* v. *Commissioner*, 625 F.2d 804, 807 (8th Cir. 1980). Contrary to petitioner's suggestions (Pet. 12-13, 19, 22), its operations are not comparable to those of the charitable HMO in *Sound Health Ass'n* v. *Commissioner*, 71 T.C. 158 (1978), acq., 1981-2 C.B. 2, or the charitable hospital in Rev. Rul. 69-545, 1969-2 C.B. 117. The findings of exempt status in those cases were premised on compelling evidence of substantial public benefit, based on community control, community-wide access to healthcare services, open medical staffing, and the provision of free emergency-room care to indigents. See *Sound Health Ass'n*, 71 T.C. at 169-172, 184-185; Rev. Rul. 69-545, 1969-2 C.B. 117. By contrast, as the courts below correctly concluded (Pet. App. 2a, 18a), petitioner's charitable activities were insignificant in relation to its overall revenue, net income, and number of persons served.

4. Petitioner contends that 26 U.S.C. 501(m), which states that certain organizations providing "commercial-type insurance" are not tax-exempt, constitutes a "savings clause" that guarantees exempt status to HMOs

that do *not* offer "commercial-type insurance." Pet. 19; see Pet. 10, 15-18. That argument was neither pressed nor passed on below, and the Court should therefore decline to consider it. See *Adickes*, 398 U.S. at 147 n.2.[3]

In any event, Section 501(m) does not grant tax-exempt status to any organization. Instead, it disqualifies an organization that otherwise meets the requirements for exempt status under Section 501(c)(3) or (4) if the organization provides "commercial-type insurance." See *Nonprofits' Ins. Alliance of Calif.* v. *United States*, 32 Fed. Cl. 277, 292 (1994) ("Congress enacted section 501(m) to restrict, not enlarge, the scope of organizations that qualify for tax-exempt status."); accord *Florida Hosp. Trust Fund* v. *Commissioner*, 103 T.C. 140, 150 (1994); *Paratransit Ins. Corp.* v. *Commissioner*, 102 T.C. 745, 755 (1994). Thus, even if petitioner could show that it does not provide "commercial-type insurance," it would not be entitled to a tax exemption because it does not satisfy the basic requirements of Section 501(c)(4).

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[3] Petitioner's new reliance on Section 501(m) also raises a question as to this Court's jurisdiction to decide that challenge. Petitioner did not invoke Section 501(m) in its administrative-refund claim but rather relied solely on Section 501(c)(4). See *United States* v. *Felt & Tarrant Mfg. Co.*, 283 U.S. 269, 272-273 (1931).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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No. 08-164

IN THE
Supreme Court of the United States

VISION SERVICE PLAN,
Petitioner,

v.

UNITED STATES,
Respondent.

On Petition for a Writ of Certiorari
to the United States Court of Appeals
for the Ninth Circuit

REPLY BRIEF FOR PETITIONER

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Supreme Court Rule 29.6, petitioner states that it has no parent companies and no publicly owned company owning 10% or more of its stock.

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Christopher M. Jedrey & Charles R. Buck,
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REPLY BRIEF FOR PETITIONER

In its Brief in Opposition, the Government silently — but directly — aims a dagger at the heart of the healthcare industry's critical non-profit sector. The IRS's approach profoundly threatens other tax-exempt organizations as well. *E.g.*, Prevent Blindness *Amicus* Br. 8-10. With its "business as usual" tone, the Government seeks to elide the pivotal fact that VSP has done nothing to change its business model since its federal tax exemption was first recognized — and thereafter honored — over 40 years ago.

With no supervening law (or even modified regulations), the IRS has done a behind-closed-doors about-face. The revenue-gathering bureau now disdains non-profit HMOs because, in the IRS's exercise of unfettered enforcement discretion, non-profit HMOs somehow look like for-profit HMOs. Indeed, in defending the Ninth Circuit's death-knell-to-non-profit-HMOs approach, the Government defends the decision below almost entirely on the basis of two premises: (1) that Vision Service Plan's operations "are primarily oriented toward its private subscribers," BIO 10, and (2) that it engages in "ordinary commercial activity" in competition with for-profit enterprises. BIO 12. But the fundamental reality is this: Both these facts are essential characteristics of health maintenance organizations generally; they are "absolutely necessary to the existence of nonprofit HMOs." Jones *Amicus* Br. 9; *see* Prevent Blindness *Amicus* Br. 6, 9-10.

Tellingly, the Government does not respond persuasively to our showing that the IRS's newly-minted position departs from long-established law.

Pet. 11-15. *See also* Prevent Blindness *Amicus* Br. 16-17; National Taxpayers Union *Amicus* Br. 3-9. Indeed, this destabilizing departure from long-understood principles — upon which numerous non-profit organizations have relied for decades in fashioning their organizational structure — finds no warrant in Congressional intent, which is demonstrably to the contrary. *See* Pet. 15-18; Jones *Amicus* Br. 6-8; Prevent Blindness *Amicus* Br. 17-21. The matter is one of substantial national importance, both practically and jurisprudentially. It urgently calls for this Court's attention.

I. VSP Is "Primarily Engaged in Promoting the Common Good," Through Promotion of Health Care for a Substantial Segment of the Community.

The Government acknowledges that VSP's "primary activity is to arrange vision-care services by connecting its paying subscribers and their enrollees to petitioner's participating providers." BIO 12. However, the Government maintains that this fact does not make VSP a "social welfare organization" under § 501(c)(4), arguing that its operations are "primarily oriented towards its private subscribers rather than toward the general public." BIO 10. The Government also asserts that "petitioner is wrong in contending (Pet. 11) that the promotion of health, standing alone, is an exempt purpose." BIO 13. For multiple reasons, the Government is wrong.

1. The Government's new position directly conflicts with Revenue Ruling 69-545, 1969-2 C.B. 117, which recognizes that promotion of health "is deemed beneficial to the community as a whole, *even though the class of beneficiaries eligible to receive a*

direct benefit from its activities does not include all members of the community, . . . provided that the class is not so small that its relief is not of benefit to the community." (Emphasis added). When the IRS later sought to back away from this position, the Tax Court firmly slapped it down, pointing out that "no charity has ever succeeded in benefiting every member of the community." *Sound Health Ass'n v. Comm'r*, 71 T.C. 158, 185 (1978). The Service acquiesced in that decision. 1981-2 C.B. 1. It now seeks to turn a blind eye on its acquiescence. The Ninth Circuit wrongly permitted it to do so.[1]

2. The Government relies on several cases for the proposition that "[a]n organization that operates primarily for the benefit of its members, rather than for the benefit of the community as a whole, is not exempt." BIO 8-10. None of these cases involved organizations promoting health care or serving another manifestly charitable purpose, such as education or religion. Nor did these cases present situations where the membership form of organization is absolutely essential to the accomplishment of the charitable purpose, *see* Jones

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[1] Revenue Ruling 69-545 correctly relied on and followed the common law of charitable trusts. The Government does not deny this, but asserts that the issue whether VSP "is a charitable organization under the common law of charitable trusts" was not raised below, and that this Court should not consider it. BIO 13. Not true.

VSP consistently argued that it qualified as "charitable" under the common law and within the meaning of § 501(c)(3), and *a fortiori* that it qualified as a "social welfare organization" under § 501(c)(4); it consistently relied on Rev. Rul. 69-545. *E.g.*, Brief on Appeal at 12-17, 24-25, 40; Reply Brief at 11-12.

Amicus Br. 3-4, 9, and in fact is required by federal law. *See* Prevent Blindness *Amicus* Br. 9-10.

In the cases cited, the taxpayers were organizations formed primarily for the private benefit of the founding members. They sought tax exemption on the basis of incidental benefits to the public at large.[2] The isolated excerpts quoted from these cases must be read in light of the facts to which they related and the issues before those courts. Read

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[2] In *Better Business Bureau, Inc. v. United States,* 326 U.S. 279 (1945), the taxpayer was a business league, primarily concerned with the profitability of its members, but performing an incidental educational function. In *Contracting Plumbers Coop. Restoration Corp. v. United States,* 488 F.2d 684 (2d Cir. 1973), the taxpayer was a plumbers' cooperative that made arrangements for street repairs for which its members were severally liable, billing the responsible member for the services. In *American Women Buyers Club v. United States,* 338 F.2d 526 (2d Cir. 1964), the taxpayer was a "tight little trade association" that primarily engaged in social activities and professional development for its members – concededly not "social welfare" functions – but incidentally provided them with health insurance. *Id.* at 428. In *Commissioner v. Lake Forest, Inc.*, 305 F.2d 814 (4th Cir. 1962), the taxpayer was a "private economic enterprise," a housing cooperative formed to acquire and maintain the housing in which its members lived; membership in the organization was limited to such residents. *Id.* at 816-817. These organizations are not remotely comparable to VSP in their mission or in their activities. *See* Pet. 6-8; BIO 4, 6 (admitting that over 40% of VSP's enrollees are beneficiaries of Government programs such as Medicaid; VSP spends 24% of its net income on charitable activities).

The Government's description of these cases is misleadingly incomplete. In particular, *Lake Forest* was not an organization for relief of veterans generally, as the Government implies. BIO 9. The nature of the enterprise was primarily private and economic, not social welfare or veterans' relief. 305 F.2d at 816-817.

in that context, these statements shed little light on the proper analysis of a case such as this, where the entire mission of the organization qualifies as charitable, and where the membership form of organization is necessary for the performance of that mission.

3. The briefs of *amici* make clear that *every* non-profit HMO's "primary purpose is to serve [its] paying members," BIO 11 (quoting Pet. App. 14a), and that this structure is essential as a practical matter to performance of its purpose, as well as required by federal law. *See* Prevent Blindness *Amicus* Br. 6; Jones *Amicus* Br. *passim.* As Professor Jones points out, "the court below relied exclusively on the very characteristic defining HMOs as the basis for precluding those organizations from tax exempt status." Jones *Amicus* Br. 8. The Government repeats this error.

4. The Government suggests in a footnote that perhaps some non-profit HMOs could justify their continued tax exemptions based on "an analysis of the facts and circumstances." BIO 11 n.1. But it does not advance a single "fact" or "circumstance" that would distinguish a typical HMO from VSP. Nor could it. If, as the Ninth Circuit held (Pet. App. 3a), healthcare services delivered to HMOs' "paying members" are entitled to *no weight* in determining whether a HMO serves a charitable purpose, or if such services are a positive *detriment* to such a finding as the Government suggests, *see* BIO 11 n.1, then "[t]he opinion below effectively raises a categorical bar against tax exemption for HMOs," Jones *Amicus* Br. 4, as well as for other charitable organizations that do not directly benefit every

member of the community. The Government fails to show how this analysis is wrong. This Court should not permit such a radical departure from existing tax law to stand.

5. The Government's amorphous "facts and circumstances" suggestion provides no more guidance than the Ninth Circuit's opaque "not enough" standard. It leaves taxpayers at the mercy of administrative whim, arbitrary enforcement, and the perils of litigation. If non-profit healthcare providers conclude that they cannot rely on tax exemptions, they will convert to commercial enterprises, changing their charitable orientation to one bent on maximizing profits and shareholder value, with well-established adverse consequences for the quality and affordability of health care. *See* Pet. 24.

6. The Government errs in seeming to argue that VSP is operated primarily for the benefit of its participating providers. BIO 11. Neither court below made such a finding or otherwise relied on such an argument. As the *amicus* brief of Professor Jones points out, "private benefit is an inevitable prerequisite to the accomplishment of a charitable or social welfare purpose. . . . Charitable health care . . . cannot possibly be accomplished without the cooperation of for-profit service providers, such as physicians . . . ." Jones *Amicus* Br. 5. The Government fails to respond.[3]

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[3] The Government recites VSP's ownership of for-profit lens laboratories and a frame manufacturer. BIO 11. Neither lower court mentioned these facts, much less relied on them; the Government does not explain their supposed significance. VSP's for-profit subsidiaries pay taxes on their profits like any

7. VSP and other HMOs are not closed insurance or risk-sharing pools similar to those the Government cites. BIO 14. On the contrary, as the Government points out (and ironically seeks to derive comfort from, BIO 12), VSP actively seeks to enroll new customers.[4] It has been quite successful in extending the national scope and affordability of its vision care – to the point that the Government now seeks to use its very success against it. *See* BIO 4.

8. The Government asserts that there is no direct conflict among the circuits, but there is a manifest conflict "with clearly expressed Congressional intent, recent Supreme Court precedent, state regulatory schemes, and well-established IRS administrative practice." Christopher M. Jedrey & Charles R. Buck, *Vision Service Plan and the HMO Guidelines,* TAXATION OF EXEMPTS 280 (May/June 2006), *quoted in* Pet. 22-23. This conflict is reflected in, among other things, the nearly 40 years of established practice between the IRS's initial recognition of

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other for-profit enterprise. VSP's share of the after-tax profits is used to discharge its charitable mission, holding down what would otherwise be the necessary cost of providing care. Investment in these enterprises does not defeat an exemption to which VSP is otherwise entitled.

[4] Surely no tax significance attaches to the fact that, during the tax year in issue, VSP did not offer individual coverage. Most American healthcare coverage comes in the form of group insurance, either employer-sponsored or through Government programs such as Medicaid and Medicare. VSP actively participates in such programs. If promotion of health care for a substantial segment of the community is beneficial to the community as a whole, as Rev. Rul. 69-545 established and the law of charitable trusts provides, VSP's enrollee base was more than large enough to meet this threshold.

VSP's tax-exempt status and its re-examination of that status in 1999. The Government offers no persuasive justification for the IRS's abrupt reversal in its interpretation and administration of a tax exemption on which non-profits and their tax advisors had relied.

* * *

Whether promotion of health care to a broad but limited class of patients is a "charitable" or "social welfare" purpose under § 501, and whether that conclusion extends to non-profit HMOs that operate in the normal manner of such organizations, are questions directly affecting the financial stability of organizations serving tens of millions of Americans, and indirectly affecting the quality of the health care that they provide. These questions, long thought to be settled, have been upset by the recent positions taken by the IRS and by the decisions below.

II. Congress Has Resolved the Issue of "Unfair Competitive Advantage" in Favor of HMOs Like VSP.

The Government asserts (as the Ninth Circuit did not, *see* Pet. App. 3a) that VSP is also disqualified from a tax exemption because it is "carrying on a business with the general public in a manner similar to organizations which are operated for profit," and a tax exemption would give it an "unfair competitive advantage." BIO 12-13. The Government is wrong, for two principal reasons.

1. The text of neither § 501(c)(3) nor § 501(c)(4) contains any exclusion of charitable or social-welfare organizations that compete with taxable entities.

This asserted limitation is found only in the regulations (and only under § 501(c)(4)). Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii).

All non-profit HMOs (and hospitals and universities and research institutions) operate in competition with profit-making organizations that provide the same or similar services. The Government is plainly wrong in suggesting that the existence of such competition automatically precludes a tax exemption.[5] The Government's resort to such arguments to justify the Ninth Circuit's decision illustrates the precise threat that the decision poses for the tax-exempt community.

2. More important, in Code § 501(m), added by the Tax Reform Act of 1986, Congress resolved the issue of "unfair competitive advantage" as it applies to incidental health insurance provided by a non-profit health maintenance organization such as VSP. At the same time that it ended tax exemptions for non-profits such as Blue Cross that provide "commercial-type insurance," Congress preserved them for non-profit HMOs that offer "incidental health insurance." § 501(m)(3)(B). The Government does not dispute that VSP is a non-profit HMO for purposes of this subsection, or that its services represent "incidental health insurance," and

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[5] Because it is in competition with others, VSP must offer competitive salaries and otherwise operate in an efficient manner to carry out its healthcare mission on a cost-effective basis. This fact does not prevent VSP from being a charitable or social-welfare organization. Again the Government fails to respond to Professor Jones's *amicus* brief, which discusses this issue at pages 5-6.

therefore are excluded from the definition of "commercial-type insurance" in Code § 501(m).[6]

Section 501(m) reflects a Congressional determination that services such as those provided by VSP should *not* disqualify a non-profit HMO from tax exemption, despite potential competition with for-profit entities. Whatever validity the Regulation may have in other contexts, it cannot defeat an exemption in a situation where Congress expressly preserved it.[7]

* * *

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[6] The Government appears now to have abandoned its previous position that VSP is disqualified because it "arranges" services rather than "providing" them, an erroneous position that it sold to the district court. Pet. App. 15a. *See* Pet. 9 n.3. Likewise the Government appears to have abandoned its argument, also wrongly accepted by the district court, that cases under § 501(c)(3) are "inapposite" to the proper construction and application of § 501(c)(4). *See* Pet. 14 n.8.

[7] The Government suggests that VSP's failure to invoke § 501(m) in its administrative claim for a refund "raises a question as to this Court's jurisdiction." BIO 14 n.3. As the Government itself observes, however, § 501(m) "does not grant tax-exempt status to any organization." BIO 14. The exemption in this case, if any, must exist under § 501(c)(4). Section 501(m) is simply a statute that must be read together with § 501(c)(4) in order to construe the latter properly – a proposition asserted in the Petition (at 17), and one that the Government does not dispute. The administrative claim was sufficient, and this Court's jurisdiction is not in question. Even in this Court, parties are not confined to the precise arguments made below as long as the ultimate issue was fairly raised. *E.g., PGA Tour, Inc. v. Martin*, 532 U.S. 661, 678 n.27 (2001); *Lebron v. National R.R. Passenger Corp.*, 513 U.S. 374, 379 (1995); *Yee v. City of Escondido*, 503 U.S. 519, 534-535 (1992).

Whether non-profit HMOs are disqualified from tax exemptions if they compete with for-profit entities (as all of them do) is another legal question critically important to a large segment of the economy and to those served by it, which urgently requires this Court's attention in light of the position now taken by the Government.

III. This Court's Prompt Intervention Is Required.

The Ninth Circuit decision should be promptly reviewed by this Court to remove crippling uncertainty in the tax law. This case presents important issues of law that were long thought to be settled, as reflected in Rev. Rul. 69-545, the IRS's acquiescence in the Tax Court decision in *Sound Health Ass'n v. Comm'r,* 71 T.C. 158, 185 (1978), the IRS's recognition of VSP's tax-exempt status in 1960, and its failure to challenge that status for some 40 years thereafter. The Government has never asserted that any relevant or material change has occurred over that time in VSP's organization and activities, and it makes no such suggestion now.

The Government and the IRS are now taking a radically different approach. This bureaucratic fiat, and its success in the courts below, "makes hash" of the law, leaving it in a state of "palpable uncertainty" and "white-hot controversy" that urgently requires this Court's review. *See* Pet. 22.

The new, ill-defined tests, inconsistent with the common law and with the clearly expressed will of Congress, provide no predictive ability whatsoever and no restraint on arbitrary and inconsistent enforcement. Left uncorrected, they will dramatically weaken the non-profit sector of the

healthcare industry, damaging both the quality, the accessibility, and the affordability of all charitable care. *See* Pet. 24.

CONCLUSION

The petition for certiorari should be granted.

Respectfully submitted.

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IN THE

Supreme Court of the United States

VISION SERVICE PLAN,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF OF AMICUS CURIAE DARRYLL K. JONES IN SUPPORT OF PETITIONER

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INTEREST OF AMICUS CURIAE

Amicus Curiae Darryll K. Jones is a Professor of Law at Stetson University College of Law in Gulfport, Florida.[1] He has served in that position for two years. Prior to that, Professor Jones served as Assistant and Associate Professor of Law and Associate Dean of Academic Affairs at the University of Pittsburgh, Pittsburgh, Pennsylvania. He served in those positions, sequentially from September 1999 until August 2006. He presently serves as co-editor of the Nonprofit Law Professor Blog, accessible online at *http://lawprofessors.typepad.com/nonprofit/*. Prior to entering the teaching profession, Professor Jones served as Associate General Counsel at the University of Florida, specializing in tax exempt law, and as General Counsel at Columbia College Chicago.

Professor Jones has written and practiced extensively in the area of tax exempt organizations. His publications include *The Tax Law of Charities and Other Exempt Organizations* (2d ed. 2007), *Third Party Profit-Taking In Tax Exemption Jurisprudence*, 2007 Brigham Young University Law Review 977 (2007), *The Scintilla of Individual Profit: In Search of Private Inurement and Excess Benefit*, 19 Virginia Tax Review

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1. No party or counsel for any party authored any portion of this brief or made a monetary contribution intended to fund the preparation or submission of the brief. No entity other than amicus curiae Darryll K. Jones or his counsel monetarily contributed to the preparation or submission of this brief. The Petitioner and the Respondent were given timely notice of the intent to file this brief under Supreme Court Rule 37, and both parties consented to the filing of this brief.

575 (2000), and *Tax Exemption Issues Facing Academic Health Centers in the Managed Care Environment*, 24 Journal of College and University Law 261 (1997) among several other publications regarding tax exemption. His publication, *When Charity Aids Tax Shelters*, 4 FLORIDA TAX REVIEW 769 (2001), served as a model for a provision subsequently enacted by Congress in an effort to police the involvement of tax exempt organizations in improper tax shelter transactions. *See* I.R.C. § 4965. Professor Jones's particular interest with respect to this case involves the application of the "private benefit" doctrine, under which the Internal Revenue Service ("the Service") denies or revokes tax exempt status on the basis that an organization improperly benefits private, noncharitable individuals.

SUMMARY OF ARGUMENT

This case involves a matter of extreme importance to the entire nonprofit health maintenance organization (HMO) industry. The court below held, based upon an unexplained and misunderstood application of the private benefit doctrine, that an HMO operating under a membership structure primarily served the private benefit of its subscribers and, therefore, is not entitled to tax exemption under section 501(c)(4) of the Internal Revenue Code. It is true that the private benefit doctrine is implicated when a nonprofit organization confers private benefit on non-charitable recipients, such as the members of the HMO. The private benefit doctrine, however, does not preclude an organization from economic dealings with a non-charitable class of persons when doing so is *necessary* to accomplish its charitable or social-welfare purpose. For example,

nonprofit hospitals routinely provide "profits" in the form of compensation to physicians and other service providers that they employ to achieve their charitable healthcare goals. Likewise, nonprofit HMOs cannot possibly achieve their charitable purpose without a membership form of organization.

The fatal flaw in the Ninth Circuit's analysis and conclusion is that (1) it fails to heed to Congress's explicit statement to the contrary and (2) it adopts a rule entirely without regard to the context surrounding the health care market place. As to the first flaw, Congress has explicitly stated that nonprofit HMOs shall not be excluded from tax exemption. *See* I.R.C. § 501(m)(3). By contrast, the court below ruled that a membership form of organization, even one providing for a subsidized dues program, precludes tax exemption. This holding directly contradicts clear congressional intent. Congress specifically exempted "health maintenance organizations" from the definition of commercial insurance activities. *See* I.R.C. § 501(m)(3)(B). In so doing, Congress was describing organizations whose defining characteristic is their existence as associations formed to control healthcare costs, to increase the supply of health care services, and to extend those services to individual unable to pay for their own care.

As to the second flaw, the modern health care marketplace demands that health care providers deliver large and predictable patient volume that can only be derived from a membership base. Virtually all HMOs are "organizations" of members who band together to obtain health services from nonprofit providers. A judicially imposed rule precluding tax exemption for

HMOs because of their invariable "membership" structure would effectively preclude tax exemption for all nonprofit HMOs, making a dead letter of Congress's careful effort to preserve tax exemption for such "organizations" of subscribers. HMOs without members have never existed and, in any event, could not compete with for-profit HMOs in order to achieve their charitable purpose of providing indispensable services.

The opinion below effectively raises a categorical bar against tax exemption for HMOs, the fiduciaries of whom seek the pubic good rather than private gain. Even as they pursue the public good, nonprofit HMO's must engage for-profit service providers. Like all tax-exempt entities, nonprofit HMOs must enter into contracts and compete for goods and services also sought by the for-profit sector. The fiduciaries of nonprofit HMO's are not exempt from the market forces prevalent in society merely because they eschew private profit in support of the public good. Thus, nonprofit HMOs, just like any other nonprofit entity must necessarily comply with implicit market rules to achieve their charitable purpose. A rule prohibiting HMOs from adopting the organizational membership structure, a structure absolutely demanded in the marketplace, effectively denies tax exempt status to all nonprofit HMOs.

ARGUMENT

A. The Membership Organization Proscribed by the Court Below Is Necessary to the Accomplishment of the Charitable and Social-Welfare Purpose for Which Congress Has Granted Tax Exemption.

The court below essentially held that a membership form of organization results in private benefit to the members and, thus, precludes tax exemption. The conclusion represents a fundamental misunderstanding of the factors necessary to achieve a charitable or social welfare purpose. The conclusion fails to distinguish effect from intent. As noted by the Internal Revenue Service and at least two commentators, private benefit is an inevitable prerequisite to the accomplishment of a charitable or social welfare purpose. Darryll K. Jones, *Third Party Profit-Taking In Tax Exemption Jurisprudence*, 2007 BYU L. Rev. 977, 981 (2007); John D. Columbo, *In Search of Private Benefit*, 58 Fla. L. Rev. 1063 (2006). In short, the public good cannot be achieved without private benefit. This is especially true with regard to a public good that is at once indispensable to the social good and subject to monopolization by for-profit healthcare providers.

Charitable health care and health care services provided for the purpose of increasing social welfare cannot possibly be accomplished without the cooperation of for-profit service providers, such as physicians who either provide the actual services or insurers who actually subsidize charitable health care via payments to nonprofit health care providers. That cooperation is gained exclusively through the ability of nonprofit health

care organizations to offer economic incentives comparable to those available from for-profit health care providers. As noted above, for-profit HMOs utilize a membership base to deliver larger patient volume to practitioners and negotiate lower fees payable by insurers. Through this process, investors in the for-profit HMOs achieve a return on their investment. Nonprofit health care organizations rely upon the same service providers and third party payers to extend those vital health care services to the poor and to encourage the search for new cures. Thus, nonprofit health care organizations must necessarily offer incentives similar to those available from for-profit health care organizations. Doing so is not indicative of intent to enrich private individuals but rather is necessary to harness market resources for the public good in a manner suitable for tax exemption.

B. Precluding Tax Exemption Because of an HMO's Membership Structure Effectively Repeals Tax Exemption Granted by Congress and Prevents All HMOs from Operating Charitably.

For the reasons explained above, a judicially imposed rule precluding tax exemption for HMOs because of their invariable membership structure would effectively preclude tax exemption where Congress has explicitly granted tax exemption. As a doctrinal matter, this outcome is directly contrary to Congress's intent. Petitioner's Petition for Writ of Certiorari adequately states the proposition:

> In 1986, Congress reviewed the tax-exempt status of health care companies in light of

> changes in the health care marketplace, particularly the increase in competitive, for-profit health insurers. As part of the Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085, Congress adopted what is now Code section 501(m). This section denies a tax exemption under 501(c)(3) and 501(c)(4) to organizations that offer "commercial-type insurance."
>
> At the same time that it revoked tax exemptions for providers of "commercial-type insurance," however, Congress expressly retained the existing tax-exempt status for nonprofit HMOs, including HMOs offering supplemental services such as vision or dental plans. Section 501(m)(3)(B) thus provides that "commercial-type insurances should *not* include "incidental health insurance provided by a health maintenance organization of a kind customarily provided by such organizations."

(Pet. for Cert. at 15-16 (footnote omitted).) Petitioner's brief continues by correctly explaining that Congress later confirmed that it intended to allow the availability of tax exempt status for organizations that "'operate in the same manner as a health maintenance organization'" (*id.* at 16). As noted above, the membership form of organization is the single defining characteristic of HMOs. Thus, the conclusion is inescapable that Congress explicitly intended to make tax exemption available to organizations that have members in an effort to increase the amount of health care services in the marketplace without limiting those services solely to those who are able to afford such services.

By contrast, the court below relied exclusively on the very characteristic defining HMOs as the basis for precluding those organizations from tax exempt status. Should its analysis prevail, the court below will have effectively overruled Congress's judgment that a membership organization is no bar to tax exempt status. Indeed, as explained above and as recognized by the market itself, utilizing a membership structure is essential to offering healthcare services whether on a for-profit or a nonprofit tax-exempt basis.

CONCLUSION

Petitioner and other amici curiae have convincingly set forth the legal basis that compels review of the opinion of the court below. The broader purpose of this brief is to place the opinion of the court below in the context of the for-profit and nonprofit health care marketplace. The opinion of the court below fails to consider the real-world healthcare marketplace in which its conclusion is to apply. Instead, it adopts an arbitrary rule without regard to the historical context in which nonprofit HMOs have existed and reaches a conclusion that, if sustained, will categorically preclude tax exemption for all nonprofit HMOs; the defining quality – indeed the factor absolutely necessary to the existence of nonprofit HMOs – is the membership structure found disqualifying by the court below. This is most certainly contrary to Congressional intent and, even worse, decreases the amount of charitable health care available to society. For these reasons, the Petition for Certiorari should be granted.

Respectfully submitted,

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VISION SERVICE PLAN,

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UNITED STATES OF AMERICA,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF OF AMICUS CURIAE NATIONAL TAXPAYERS UNION IN SUPPORT OF PETITIONER

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INTEREST OF AMICUS CURIAE[1]

The National Taxpayers Union ("NTU") was founded by concerned taxpayers in 1969. It is a nonprofit, nonpartisan membership organization devoted to protecting the interests of federal, state and local taxpayers though public education, lobbying, and litigation on tax, spending, regulatory and economic issues. NTU represents over 362,000 members in all fifty states.

NTU has long been involved in IRS reform and taxpayer rights issues. For example, the group actively supported the IRS Restructuring and Reform Act of 1998 and in the 10 years since, NTU has pursued additional laws and regulations that will make tax administration simpler, more consistent, and less arbitrary. The petition raises compelling questions regarding a tax exemption that is of crucial importance to many entities that contribute vitally to our society. NTU's goal of obtaining greater predictability, consistency and simplicity in tax administration is very much at stake in this case, and NTU believes its perspective on tax questions will be of assistance to the Court in evaluating the petition.

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1. No counsel for a party authored this brief in whole or in part, and no such counsel or party made a monetary contribution intended to fund the preparation or submission of this brief. No person other than the *amicus curiae*, or its members, or counsel, made a monetary contribution to its preparation or submission. The parties have consented to the filing of this brief and have been given the required 10 day notice. Such consents are being lodged herewith.

NTU does not in this brief repeat petitioner's well-reasoned analysis of the Ninth Circuit decision and the problems created thereby. NTU submits this brief solely to highlight three aspects of the Ninth Circuit's opinion that warrant certiorari review. First, by articulating an amorphous test for application of the Internal Revenue Code section 501(c)(4) tax exemption with no guidelines for how to apply the test, the decision creates a quandary for non-profit organizations that depend on the exemption but have no meaningful guidance regarding its application to them. Second, by granting the IRS virtually unlimited discretion to apply an eye-of-the-beholder legal standard, the Ninth Circuit's test fosters undue instability, uncertainty and inconsistency in this area of the law. Third, the courts should leave to the legislative process any decision to depart from the more consistent and predictable interpretation of the exemption that the IRS previously had applied for decades and that Congress had endorsed in its 1986 amendments to the Code.

THE COURT SHOULD GRANT THE PETITION BECAUSE THE QUESTION PRESENTED IS OF EXCEPTIONAL IMPORTANCE, YET THE NINTH CIRCUIT'S DECISION LEAVES THAT IMPORTANT QUESTION UNCERTAIN AND VULNERABLE TO THE WHIM OF THE TAX AGENCY

A. By Employing An Ambiguous Legal Standard To Affirm The IRS's Revocation Of A Tax Exemption That A Non-Profit Organization Had Enjoyed For Over 40 Years, The Ninth Circuit Has Injected Substantial Ambiguity Into A Sector That Needs Certainty

Vision Service Plan ("VSP") is organized and operates in the same way it did nearly a half century ago, when the IRS first recognized its tax exempt status. (Petition at 4, 8) The only appreciable change is that VSP has grown in a manner that makes its healthcare service available to even broader portions of the community. (*Id.*) The language of Internal Revenue Code section 501(c)(4) granting a tax exemption to "social welfare" organizations likewise has not changed at any time since VSP's exemption was recognized in 1960. (*Id.*)

Although there has been no material change in fact or law (other than the 1986 statutory amendments that, as explained in VSP's petition, bolster VSP's position), the IRS has overturned its longstanding interpretation and revoked a tax exemption that VSP had enjoyed for over 40 years. That result not only will cost VSP millions, but it represents an even more disturbing shot across the bow to other non-profit organizations that presently enjoy tax exempt status under Section 501(c)(4).

Prior to the decisions below, many non-profit HMOs could comfortably rely on the Section 501(c)(4) exemption. After all, as VSP details in its petition, the IRS's own Revenue Rulings and internal guidelines, Congress's expressed judgment in the 1986 statutory amendments that added section 501(m) to the Code, and the common law all treated the provision of a valuable public good—healthcare services—to a broad segment of the community—the HMO's subscribers—as generally sufficient to establish the right to an exemption as a social welfare organization. That standard was clear, could be predictably applied, mirrored Congress's expressed intent and appeared settled prior to the decisions below.

The Ninth Circuit's decision, however, endorses a fundamental change in the interpretation and application of Section 501(c)(4). *See, e.g.*, C. Jedrey and C. Buck, *Health Care Organizations*, TAXATION OF EXEMPTS 280 (May/June 2006) at p. 282 ("If the IRS adopted the [district] court's conclusion that operating primarily for the benefit of paying members precludes tax-exempt status for HMOs under Section 501(c)(4)—and one would expect under Section 501(c)(3) as well—the result would be loss of tax exempt status for almost all currently tax-exempt HMOs").

The Ninth Circuit held that a non-profit HMO that provides services to a substantial segment of the community did not qualify as tax-exempt under Section 501(c)(4) because the HMO was not "primarily engaged in promoting the common good and general welfare of the community." (Mem. Disposition at 2) The Ninth Circuit acknowledged that "VSP offers some public

benefits," but held those benefits were "not enough." (*Id.*) The decision views the provision of services to subscribers as an activity that does not benefit the community sufficiently, but did not explain either what additional type of "public benefits" are required to qualify or what quantum of those activities make the grade.

As a result, non-profit HMOs who previously had every reason to believe they were tax exempt, now have a large cause for concern. But since the Ninth Circuit indicated neither the types of activities nor their quantum that will meet its "public benefits" litmus test, these organizations have no way to evaluate the risk that the tax exemption on which they critically depend could be revoked.

As VSP's experience demonstrates, moreover, these non-profit entities also can draw no comfort from the IRS's prior treatment of them as exempt social welfare organizations. If the IRS can abruptly reverse course without any material change in fact or law in the case of an organization that has enjoyed tax exempt status for over 40 years, no other organization can feel safe.

The Ninth Circuit's slender analysis is all the more troubling because, as part of its Internal Revenue Manual, the IRS has published specific audit/examination guidelines to determine whether HMOs and similar entities qualify for exemption under Sections 501(c)(3) or (c)(4).[2] The IRM directs examiners to assess

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2. Internal Revenue Manual 7.8.1, E.O. Examination Guidelines Handbook, Chapter 27, Health Maintenance Organizations (IRM) at http://www.irs.gov/bus_info/tax_pro/irm-part/part07, located at Petitioner's Excerpts of Record (filed below) at 107-108.

whether the organization enrolls more than an "insubstantial" number of persons who are generally unable to obtain affordable health care services or health care insurance. This includes individuals, employer groups consisting of employers having 50 or fewer employees, elderly persons such as persons who qualify for Medicare benefits, low income persons, or others with special health care needs. (IRM § 4.76.31.8.3.2) The IRM also directs examiners to determine whether the HMO's premium calculation methods result in premiums that are "generally affordable." (IRM § 4.76.31.8.3.3) And the examiner should determine whether the HMO is controlled by community interests rather than by health care providers or others who can benefit personally from the HMO's operations; an important factor in this analysis is whether the organization has a substantial conflict of interest policy that minimizes any impermissible private benefit. (IRM § 4.76.31.8.3.4)

Notwithstanding these detailed IRS guidelines addressing the very subject before the Court, the Ninth Circuit did not even mention the guidelines. Although the guidelines are, of course, not controlling,[3] the Ninth Circuit's failure to explain either why VSP failed to fit into those guidelines or why the Court would not apply the guidelines (as the case may be) leaves other HMOs at a loss as to whether they can continue to draw any meaningful predictive value from guidelines that have helped shape their behavior for years. *See* T. Blais, *California Judge Makes Hash of Tax Exempt HMOs in Vision Service Plan*, 7 TAX & FINANCE, Issue 1 (March 2006) at p. 8 ("Historically, the IRS has promoted

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3. *See, e.g., In re Carlson*, 125 F.3d 915, 922 (7th Cir. 1997).

these guidelines informally to HMOs and practitioners, and HMOs have relied upon these standards in developing and monitoring their activities to ensure continued compliance with § 501(c)(4).").

Our law strives for stability and certainty in the law's articulation and enforcement so parties can organize their affairs with predictable legal consequences. That is why courts follow the doctrine of *stare decisis*. "That doctrine permits society to presume that bedrock principles are founded in the law rather than in the proclivities of individuals, and thereby contributes to the integrity of our constitutional system of government, both in appearance and in fact." *Vasquez v. Hillery*, 474 U.S. 254, 265-66 (1986). The doctrine also avoids disturbing settled practices that have emerged in reliance on the earlier precedent. *See, e.g., Rhode Island v. Innis*, 446 U.S. 291, 304 (1980) (Burger, C. J., concurring in judgment) ("The meaning of *Miranda* has become reasonably clear and law enforcement practices have adjusted to its strictures; I would neither overrule *Miranda*, disparage it, nor extend it at this late date").

While "'stare decisis is not an inexorable command,'" *State Oil Co. v. Khan*, 522 U.S. 3, 20 (1997) (*quoting Payne v. Tennessee*, 501 U.S. 808, 828 (1991)), "even in constitutional cases, the doctrine carries such persuasive force that we have always required a departure from precedent to be supported by some 'special justification.'" *United States v. International Business Machines Corp.*, 517 U.S. 843, 856 (1996) (*quoting Payne, supra*, at 842 (Souter, J., concurring) (*in turn quoting Arizona v. Rumsey*, 467 U.S. 203, 212 (1984))). That a legal interpretation has become

embedded in practice is adequate reason not to overrule it—absent an identified justification for doing so. *See Mitchell v. United States*, 526 U.S. 314, 331-332 (1999) (Scalia, J., dissenting) (stating that the fact that a rule has found "'wide acceptance in the legal culture'" is "adequate reason not to overrule" it).

The same concerns that have prompted courts to place a heavy burden of persuasion on those who wish to overturn precedent likewise warrant caution in any departure from an administrative practice that has taken root over four decades. After all, unexplained reversals of long-standing administrative interpretations likewise undermine society's ability to presume "that bedrock principles are founded in the law rather than in the proclivities of individuals." *Vasquez*, 474 U.S. at 265. Caution in departures from established agency practice also promotes society's interests in stability, certainty and predictability in the application of law.

Here, however, the Ninth Circuit and IRS offered little justification for changing course—even though the change is a fundamental one that threatens to upset settled expectations throughout the healthcare sector. That lack of guidance is troubling to those not only in the healthcare sector but far beyond.

Many other organizations who are important to our civic life rely on a Section 501(c)(4) exemption.[4] Given

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4. 501(c)(4) organizations span the political and economic spectrum from the AARP to the Disabled American Veterans to the League of Conservation Voters to the National Rifle Association.

the dearth of well-reasoned precedent articulating the criteria for qualifying as a "social welfare" organization, these organizations also have looked to the IRS's interpretations and guidelines. The Ninth Circuit here, however, issued a 2-page memorandum that simply parroted the language of the statute and the sole regulation adopted under it and offered a conclusory assessment that VSP failed to qualify. The lack of discussion of prior IRS interpretations, guidelines, the statutory scheme as a whole including the 1986 amendments, and pertinent common law leaves other social welfare organizations uncertain as to how much stock they can place in any of these extrinsic aids in construction. The need for this Court's guidance is therefore compelling.

As NTU now explains, moreover, given the many years of administrative experience built into the previously settled interpretation of Section 501(c)(4), the potential implications of an improvident change in that settled practice and Congress's expressed judgment in this area, the Court should hold that the long standing interpretation should govern and the courts should leave any departures from those interpretations to the legislative process.

B. The Legislative Process Is Better Suited To Evaluate The Wisdom Of Any Departure From The View That The Services HMOs Deliver To Their Subscribers Benefit The Community Sufficiently To Support Exemption Under Section 501(c)(4)

Our multi-trillion dollar healthcare system is under intense scrutiny by policymakers, and a growing literature asserts that non-profit HMOs may deliver greater social benefits than for-profit HMOs.[5] But non-profit HMOs who previously could count on a Section 501(c)(4) exemption now face an uncertain future where they lack meaningful guidance on the availability of their exemption and know that the IRS's long-standing recognition of their exemption is no guarantee that the IRS may not abruptly reverse course. Non-profit hospitals and others healthcare organizations that rely on a tax exemption face the same dilemma. These non-profits also can no longer rely on the view that their provision of healthcare to the populations they serve confers sufficient community benefits to support an exemption and must instead guess whether their operations fit within the Ninth Circuit's vague "public benefits" test. Since many of these organizations already

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5. *See, e.g.*, Schlesinger, Mitchell and Gray, *Measuring Community Benefits Provided by Nonprofit and For Profit HMOs*, 40 Inquiry 114 (Summer 2003) (non-profit HMOs are more likely than for-profits to provide subsidies and to support research and other community benefit activities); Tu and Reschovsky, *Assessment of Medical Care by Enrolles in For-Profit and Non-Profit Health Maintenance Organizations*, 346 New England Journal Medicine 1288 (4/25/02) (higher levels of patient satisfaction found in nonprofit HMOs).

face disadvantages in competing with for-profit operators, many may not wait until they suffer VSP's fate and may instead reorganize to operate on a for-profit basis.

Given the potential implications of any such shift, any decision to change the standards by which tax-exemptions in the healthcare field are judged is best left to either Congress or the administrative rule-making process. Doing so permits public comment, thereby allowing for a careful evaluation of the realities of the marketplace, the experience of the last four decades and all other relevant considerations.

Neither the Ninth Circuit, the district court nor the IRS even purported to perform the type of comprehensive evaluation that is warranted for a change of this magnitude. Since they did not do so, it would have been more prudent to stick with the interpretation that previously had prevailed for over 40 years. That interpretation had the benefit of many years of practical application, and Congress endorsed that interpretation in its 1986 statutory amendments.

The above concerns extend well beyond healthcare non-profits. The availability of a tax exemption may prove to be the difference between survival or demise for many of these organizations. These entities and the persons they serve are entitled to better guidance. They should not be forced to proceed under a regime where an undefined, eye-of-the-beholder "public benefit" standard is left to the whim of an agency that has demonstrated it may disturb settled expectations without advancing any compelling justification for

changing course. Our society's interest in greater predictability, consistency and simplicity in tax administration is yet another reason why this case is worthy of this Court's consideration.

CONCLUSION

The petition for writ of certiorari should be granted.

Respectfully submitted,

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IN THE

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VISION SERVICE PLAN,
Petitioner,

v.

THE UNITED STATES OF AMERICA,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF OF *AMICI CURIAE* PREVENT BLINDNESS AMERICA ET AL. IN SUPPORT OF PETITIONER

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IN THE

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BRIEF OF *AMICI CURIAE* PREVENT BLINDNESS AMERICA ET AL. IN SUPPORT OF PETITIONER

INTEREST OF THE *AMICI CURIAE* [1]

Amici curiae Prevent Blindness America, the National Association of School Nurses and the National

[1] Pursuant to Supreme Court Rule 37.6, the *amici curiae* — the National Society to Prevent Blindness (d/b/a Prevent Blindness America), the National Association of School Nurses and the National Council of La Raza — affirm that no counsel for any party authored this brief in whole or in part. No person or entity — other than the *amici curiae*, their members, or their counsel — made a monetary contribution specifically for the preparation or submission of this brief. Pursuant to Supreme Court Rule 37.2(a), the *amici curiae* respectfully submit this brief in support of the petition for a writ of certiorari. All of the parties have consented in writing to the filing of this brief, and copies of the consent letters have been filed with the Court.

Council of La Raza are nonprofit charitable organizations. Although the *amici curaie* have diverse histories and purposes, they share the common goal of protecting and improving the eyesight of uninsured and underinsured children as partners in the Sight for Students program established by petitioner Vision Service Plan.

Prevent Blindness America ("PBA") is the nation's leading nonprofit organization dedicated to preventing blindness and improving eyesight. A small group of social leaders and scientists in New York City founded PBA in 1908. They created the organization in response to a simple question posed by Louisa Lee Schuler, one of PBA's founders — "Can it be possible that in a civilized country like our own, one in which the most scientific methods are supposed to be in use, babies are allowed to lose their eyes when they might have been saved?"

Since its inception, PBA and its partners have worked to ensure that no child is robbed needlessly of a lifetime of sight. As one of its first acts of public service, PBA successfully championed legislation that virtually eliminated one cause of infant blindness — ophthalmia neonatorum — by mandating that all newborns receive eye drops containing silver nitrate. Over the last 100 years, PBA has continued on its mission to eliminate preventable blindness and preserve and improve sight through public and professional education, advocacy, certified vision screening and training, community and patient service programs and research. PBA has set as one of its goals that by 2020 it will reduce vision loss by ensuring that all children receive appropriate vision care as they enter school.

With nearly 14,000 members, the National Association of School Nurses ("NASN") is the nation's largest association of school nurses and it operates as a hub for affiliated state associations throughout the country. Originally established by the National Education Association in 1968, NASN's purpose is to improve the quality of school nursing, the health of school children, and the ability of children to succeed in the classroom. NASN members represent almost every facet of school health care delivery, including school nurses in public and private schools, school nurse administrators and school nurse educators.

NASN has been working to improve the health of the nation's school children for more than forty years. As a core part of its mission, NASN sets standards of practice and provides educational programs to school nurses. NASN has also fought for positive changes to the nation's health care policy. Among its other activities, NASN has sponsored research, published issue briefs and position statements, and advocated to Congress for policies that will promote student health and school nursing.

The National Council of La Raza ("NCLR") is the largest national Hispanic civil rights and advocacy organization in the United States. Founded in 1968, NCLR was established to address the fundamental lack of institutional support for the Mexican American community and the lack of public awareness regarding the challenges facing that community. In the forty years since its founding, NCLR and its network of nearly 300 affiliated community-based organizations has expanded its mission to focus on improving opportunities for all Hispanic Americans. NCLR and its affiliates touch the lives of millions of Hispanic Americans each year in 41 states, Puerto

Rico, and the District of Columbia, focusing on issues of health care, civil rights, immigration, education, and investment in Hispanic communities.

The national advocacy and community-based assistance provided by PBA, NASN and NCLR is made possible, in large part, by the charitable support of partners, volunteers, and contributors.[2] Petitioner Vision Service Plan ("VSP"), through its Sight for Students Program, has been an important and generous contributor to the community-based efforts of PBA, NASN and NCLR (collectively, the "SFS Partners").

Sight for Students is a VSP-sponsored charity that, since its inception in 1997, has provided free eye exams and glasses to hundreds of thousands of children from low-income and underprivileged families.[3] The program operates nationally through a network of community partners, including the SFS Partners, that conduct vision screenings on a local level to identify children with eye or vision problems. Once such a child is identified, the SFS Partner provides the child with a voucher from VSP that the child can redeem to receive free eye care services from a VSP network doctor. Combined, the three SFS Partners that are *amici curiae* here have distributed more than 275,000 vouchers that have been redeemed for

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[2] PBA, NASN and NCLR are nonprofit, tax-exempt organizations classified as public charities under § 501(c)(3) of the Internal Revenue Code. The tax-exempt status of these three organizations is not called into question by the Ninth Circuit's decision.

[3] To participate in the Sight for Students program, a child must (among other requirements) be part of a family with an income that is no more than 200% of the federal poverty level and must not be eligible for Medicaid or other vision insurance.

over $55 million in free eye care and eyewear. In total, VSP vouchers have been redeemed by nearly half a million children across the country for more than $90 million in free eye care and eyewear.

The SFS Partners have joined as *amici curiae* because they believe that the Ninth Circuit's decision upholding the IRS's revocation of VSP's tax-exempt status frustrates, rather than furthers, their shared goal of improving and protecting the sight of America's children. Specifically, the Ninth Circuit's decision threatens to divert to the federal treasury funds from the Sight for Students program that are needed to provide eye care to low-income, uninsured, and underinsured children. The adverse impact of the Ninth Circuit's ruling, thus, extends far beyond VSP, undermining the mission of the SFS Partners and, far more importantly, jeopardizing the eye care of hundreds of thousands of children.

The SFS Partners also are concerned that the Ninth Circuit's decision could have detrimental effects on other charitable institutions and programs that extend beyond the Sight for Students program. As we explain below, the Ninth Circuit's decision threatens not only the tax-exempt status of all nonprofit Health Maintenance Organizations ("HMOs"), but also the continued viability of the charitable programs sponsored by those nonprofit HMOs. Given the substantial harm that could be caused by the Ninth Circuit's decision, the SFS Partners submit this brief as *amici curiae* in support of petitioner VSP.

SUMMARY OF ARGUMENT

The IRS and Ninth Circuit have intruded into the province of the legislature by rewriting decades of settled health care tax policy to threaten the very

existence of nonprofit HMOs. The potential ramifications of this case extend far beyond the revocation of petitioner VSP's 40-year tax-exempt status. The Ninth Circuit's decision calls into question the tax-exempt status of every subscriber-based, nonprofit health care entity.[4] The collateral damage of the Ninth Circuit's decision extends far beyond nonprofit HMOs themselves to include charitable entities, such as the SFS Partners, that rely heavily on charitable contributions from nonprofit HMOs such as VSP.

In its decision, the Ninth Circuit ruled that an entity cannot qualify for tax-exempt status under 26 U.S.C. § 501(c) "if the entity's primary purpose * * * is to establish a fund from payments by subscribers to defray and assume the costs of health care for those subscribers." App. 2a. Every nonprofit HMO shares this same primary purpose. In fact, Congress, by statute, has mandated that a health care entity must embody these basic qualities to qualify under federal law as an HMO. *See* 42 U.S.C. § 300e(a)-(b). As a result, no nonprofit HMO can qualify for tax-exempt status under the Ninth Circuit's interpretation of § 501(c), because each one arguably has as its primary purpose the provision of health care to a finite population of subscribers rather than the promotion of the "general welfare of the community." Pet App. 2a. In coming to this conclusion, the Ninth Circuit reversed the status quo in which, for over four decades, nonprofit, subscriber-based HMOs have been granted tax-exempt status.

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[4] The decision below of the United States Court of Appeals for the Ninth Circuit in *Vision Serv. Plan v. United States*, 265 F. App'x 650 (9th Cir. 2008), is reproduced in the Appendix to VSP's petition ("Pet. App.") at pages 1a-3a.

In addition to calling into question the tax-exempt status of all nonprofit HMOs, the Ninth Circuit's decision imperils countless charities, like the SFS Partners, that rely upon contributions by nonprofit HMOs to provide healthcare to underserved communities. The Ninth Circuit's decision risks diverting to the federal treasury funds that are currently being used to support community-based charitable programs, and it removes the incentive for nonprofit HMOs to retain their nonprofit status and to maintain their current level of contributions to charitable programs. Empirical evidence confirms that nonprofit HMOs contribute more generously (by a significant margin) to charities than their for-profit counterparts. *See infra*, p. 12.

VSP's Sight for Students program provides a perfect example of the kinds of charitable endeavors that are placed in jeopardy by the Ninth Circuit's decision. Over the last decade, VSP's Sight for Students program has improved the sight (and as a result the academic performance, athletic capability and self-esteem) of almost half-a-million children from low-income and underprivileged families at a cost to VSP of $92.3 million. By upholding the IRS's revocation of VSP's tax-exempt status, the Ninth Circuit jeopardizes the ability of hundreds of thousands of children to obtain vision care through the Sight for Students program over the next decade. Even worse, the Sight for Students program is but one program, by one nonprofit HMO, in one segment of the health care community. Given the sweeping effect of the Ninth Circuit's analysis, the appellate ruling could have devastating consequences across the country for charities and the communities that rely upon them.

A change of decades-established federal law with consequences of this magnitude should come from only one source — Congress. And yet, Congress has unambiguously stated, in the plain words of the Internal Revenue Code and in supporting legislative history, that it intends for nonprofit HMOs to continue to be eligible for tax-exempt status. When Congress enacted 26 U.S.C. § 501(m) to remove the Blue Cross and Blue Shield entities' tax-exempt status under § 501(c), it specifically included a provision, § 501(m)(3)(B), to protect the tax-exempt status of nonprofit HMOs. In doing so, Congress unambiguously conveyed its intent for nonprofit HMOs to retain their tax-exempt status. The Ninth Circuit's decision contradicts this clear intent. The Ninth Circuit's decision also renders § 501(m)(3)(B) meaningless. If, as the Ninth Circuit's decision implies, no nonprofit HMO can qualify for tax-exempt status under § 501(c), then § 501(m)(3)(B), which applies only to tax-exempt nonprofit HMOs, has no effect.

Because the Ninth Circuit's decision reverses a status quo in federal law that has been settled for decades, contravenes Congress's intent, renders a statutory provision meaningless, and, most importantly, imperils charities and the populations they serve throughout the country, the Ninth Circuit's decision warrants review by this Court.

ARGUMENT

I. THE NINTH CIRCUIT'S DECISION ENDANGERS IMPORTANT CHARITABLE PROGRAMS, SUCH AS SIGHT FOR STUDENTS.

The Ninth Circuit's decision upholding the IRS's revocation of VSP's tax-exempt status is, in effect, the

death knell for nonprofit HMOs. For more than three decades — since a court first recognized the tax-exempt status of nonprofit HMOs in *Sound Health Ass'n v. Commissioner*, 71 T.C. 158 (1978) — it has been an accepted principle of federal law that nonprofit HMOs are eligible for tax-exempt status under 26 U.S.C. § 501(c). Nonprofit HMOs were granted tax-exempt status based on the fundamental premise, formalized by the IRS in Rev. Rul. 69-545, 1969-2 C.B. 117, that "the promotion of health is considered to be a charitable purpose."

The Ninth Circuit's decision upends federal tax law by rejecting this premise. The Ninth Circuit began its decision by noting that the relevant regulation, 26 C.F.R. § 1.501(c)(4)-1(a)(2)(i), requires nonprofit HMOs such as VSP to be "primarily engaged in promoting in some way the common good and general welfare of the community." Pet. App. 2a. The Ninth Circuit then concluded, contrary to the understanding of federal law that has prevailed for more than three decades, that VSP could not qualify for tax-exempt status because:

> "VSP's own articles of incorporation state that the primary purpose of the corporation is to establish a fund from payments by subscribers to defray and assume the costs of vision care for those subscribers. This is a purpose that benefits VSP's subscribers rather than the general welfare of the community." *Id.*

The Ninth Circuit's decision to revoke VSP's tax-exempt status based on this statement in VSP's articles of incorporation should not be allowed to stand, because in this respect VSP's articles of incorporation merely state the minimum statutory requirements for a health care entity to qualify as an

HMO under federal law. The defining characteristics of an HMO are that it establish a subscriber base, collect payments from its subscribers, and in return, provide health care to those subscribers. Congress set forth these elements in 42 U.S.C. § 300e(a)-(b). The relevant portion of § 300e(a) states:

> "the term 'health maintenance organization' means a public or private entity which is organized under the laws of any State and which (1) provides basic and supplemental health services to its members in the manner prescribed by subsection (b) of this section."

Subsection (b) of § 300e then provides in pertinent part:

> "Each member is to be provided basic health services for a basic health services payment which (A) is to be paid on a periodic basis without regard to the dates health services (within the basic health services) are provided * * *." *Id.* § 300e(b)(1).

In short, the Ninth Circuit revoked VSP's tax-exempt status solely because VSP complied with the basic requirements for an HMO imposed by federal law.

The scope and likely consequences of the Ninth Circuit's decision are far reaching. In effect, the Ninth Circuit has ruled that nonprofit HMOs cannot qualify for tax-exempt status under § 501(c) because of their inherent — and statutorily mandated — purpose of providing health care services to a base of paying subscribers. This ruling has potentially devastating consequences not only for nonprofit HMOs, but also for the charities, like the SFS Partners, that rely upon contributions from nonprofit HMOs. By issuing a decision that precludes nonprofit HMOs

from retaining tax-exempt status, the Ninth Circuit has endangered such charities in two significant ways.

First, the Ninth Circuit's decision diverts to the federal treasury funds that are currently needed to maintain the viability of charitable programs throughout the United States. Nonprofit HMOs, like VSP, have a limited supply of money to divide between providing health care to subscribers and supporting charitable programs. HMOs have no choice but to provide health care to subscribers. As a result, nonprofit HMO's will almost certainly have no choice but to look to pay their newly-imposed tax liability, at least in part, from funds previously allocated to charitable programs.

Second, the Ninth Circuit's decision removes the legal incentive for nonprofit HMOs to continue to support charitable programs to maintain their nonprofit status. Prior to this case, the IRS had taken the position that nonprofit health care entities must provide "at least some 'indicia of charity' in the form of serving the public and providing some services free of charge." See, *e.g.*, *Geisinger Health Plan v. Comm'r*, 985 F.2d 1210, 1216 (3d. Cir. 1993). Similarly, states have imposed community service requirements as prerequisites to nonprofit status. See, *e.g.*, *Hospital Utilization Project v. Commonwealth of Pennsylvania*, 487 A.2d 1306, 1316-1317 (Pa. 1985). By erecting a barrier to tax-exempt status that, for nonprofit HMOs, is insurmountable, the Ninth Circuit has eliminated the financial incentive for these nonprofit HMOs to continue to engage in charitable endeavors.

If not reversed, the Ninth Circuit's decision could have disastrous consequences for charitable pro-

grams. Across the country, nonprofit HMOs provide health care to low-income, uninsured and underinsured Americans, and support charitable programs in their local communities. The detrimental impact of withdrawing tax-exempt status from nonprofit HMOs is not speculative. A comprehensive comparison of the community benefit activities of nonprofit and for-profit HMOs concluded:

> "Nonprofit HMOs were significantly more likely to provide subsidies for medical services in the community and to support safety-net health care agencies, including support for community health centers and mental health centers. Nonprofit HMOs also were more likely to target their community benefit programs to low-income neighborhoods in the communities that they serve. Also observed were consistent ownership-related differences in terms of more general philanthropy * * *."[6]

To appreciate the full extent of the harm caused by the Ninth Circuit's decision, the Court must understand the substantial good work done by the charities sponsored by nonprofit HMOs. VSP's Sight for Students program provides a compelling example and demonstrates the difference that can be made by one such charitable program.

VSP founded the Sight for Students program in 1997 to provide free eye exams and glasses to low-income, uninsured and underinsured children. The program addresses a significant need. According to

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[6] Mark Schlesinger, Shannon Mitchell & Bradford Gray, *Measuring Community Benefits Provided by Nonprofit and For-Profit HMOs*, 40 INQUIRY 114, 126-127 (Summer 2003), *available at* http://lists.allenpress.com/INQR/i0046-9580-040-02-0114.pdf.

the American Optometric Association, one in four children have some form of vision problem.[6] Yet, studies have demonstrated that only 25 percent of preschool-age children receive any kind of vision testing.[7]

A vision problem, left uncorrected, can do serious harm to a child's development and quality of life. According to the Center for Disease Control and Prevention, "[i]mpaired vision can affect a child's cognitive, emotional, neurological and physical development by possibly limiting the range of experiences and kinds of information [to which] the child is exposed."[8] The effect of an uncorrected vision problem on the ability of a child to succeed in school can be devastating. Approximately 80 percent of what a child learns is learned visually.[9] Some vision problems, if not corrected at an early age, can lead to permanent disability and blindness. For example, amblyopia, or "lazy eye," is a condition affecting "2 to 3 out of every 100 children" and results in reduced vision in an eye that has not received adequate use during early childhood.[10] If left untreated until age

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[6] American Optometric Association, Ready for School, Frequently Asked Questions Regarding Children's Vision, http://www.aoa.org/x5068.xml.

[7] Richard C. Wasserman, Candace A. Croft, Sarah E. Brotherton, *Preschool Vision Screening in Pediatric Practice: A Study from the Pediatric Research in Office Settings (PROS) Network*, 89 PEDIATRICS 834, 834 (1992).

[8] Center for Disease Control and Prevention, What is Vision Impairment? (Oct. 29, 2004), http://www.cdc.gov/ncbddd/dd/vision2.htm.

[9] American Optometric Association, School-Aged Vision: 6 to 18 Years of Age, http://www.aoa.org/x9451.xml#1.

[10] National Eye Institute, Amblyopia (Mar. 2008), http://www.nei.nih.gov/health/amblyopia/amblyopia_guide.asp.

six, amblyopia will most often result in some permanent vision impairment. If left untreated until age ten, the eye may become functionally blind.

Uncorrected vision problems are also a significant drain on the nation's economy. A 2002 study reported that untreated amblyopia alone costs the United States an estimated $7.4 billion in earning power each year.[11] If a child becomes visually impaired, the additional costs for medical visits, home modifications and lost productivity are estimated at $601,000 over the child's lifetime.[12]

The Sight for Students program addresses the problem of childhood vision impairment in two steps — vision screening and treatment. VSP's community partners, including the *amici curiae* SFS Partners, identify children in need. PBA, for example, conducts vision screenings in communities across the United States that are otherwise underserved. From 2000 to 2007, PBA-certified vision screeners screened more than 11 million children, referring approximately 935,000 for comprehensive eye care. Many of the vision problems afflicting these children otherwise would have gone undetected. NASN members identify children in need pursuant to their duties as caregivers within the school community. NCLR identifies

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[11] Jaime H. Membreno, Melissa M. Brown, Gary C. Brown, Sanjay Sharma & George R. Beauuchamp, *A Cost-utility Analysis of Therapy for Amblyopia*, 109 OPHTHALMOLOGY 2265, 2269 (2002).

[12] Center for Disease Control and Prevention, *Economic Costs Associated with Mental Retardation, Cerebral Palsy, Hearing Loss, and Vision Impairment — United States, 2003* (Aug. 18, 2006), http://www.cdc.gov/mmwr/preview/mmwrhtml/mm5303a4.htm, *amended by erratum at* http://www.cdc.gov/mmwr/preview/mmwrhtml/mm5532a5.htm.

children in need through its network of affiliated charter schools, daycare centers and health programs in predominantly Hispanic communities.

These screening efforts — though a vital component of the Sight for Students program — would be futile in many cases without the charitable participation of VSP. The most challenging element of any screening program is ensuring that those who fail the screening receive the appropriate follow-up care. VSP provides that care to children in need by distributing vouchers to its SFS Partners that can be redeemed for free eye exams and glasses from any VSP network doctor.

The Sight for Students program makes a real difference. Every year, VSP network doctors correct the vision of more than 50,000 children through the Sight for Students program. Since the program's inception, VSP has provided free eye care and eyewear to more than 472,000 children at an average cost of approximately $195 per child. Without Sight for Students, it is highly unlikely that these children would have received the eye care and eyewear they needed to excel in academic and physical activities and to maintain a healthy self-esteem. These services have been provided at a substantial cost to VSP. The total value of the free health care provided by VSP through the Sight for Students program is approximately $92.3 million.

As beneficent as the Sight for Students program is — substantially improving the quality of life of almost half-a-million children over the last decade — it is but one charity, addressing one kind of need, sponsored by one nonprofit HMO. Throughout the United States, other nonprofit HMOs participate in similar community benefit programs. As we noted

above, *supra* p. 12, nonprofit HMOs are significantly more likely than their for-profit counterparts to sponsor or participate in community benefit programs that target low-income neighborhoods. The Ninth Circuit's decision needlessly imperils these programs, to the detriment of low-income communities across the country.

II. THE NINTH CIRCUIT'S DECISION IS CONTRARY TO CONGRESS'S INTENT FOR NONPROFIT HMOs TO REMAIN ELIGIBLE FOR TAX-EXEMPT STATUS.

If countless charities throughout the United States are to be imperiled by the elimination of tax-exempt status for nonprofit HMOs, it should be because Congress has exercised its democratic mandate to enact legislation setting the nation's health care policy. That is not what happened in this case. For four decades, it has been accepted federal law that "the promotion of health is considered to be a charitable purpose" that qualifies nonprofit health care organizations for tax-exempt status under § 501(c). Rev. Rul. 69-545, 1969-2 C.B. 117. Congress enacted no law altering this fundamental principle. Nor did the IRS issue a regulation. Rather, the IRS simply decided that it no longer wished to follow its own Revenue Ruling.

The Ninth Circuit's approval of this reversal-of-course by the IRS in an unpublished decision impermissibly contradicts Congress's intent and renders a statutory provision enacted by Congress meaningless. This Court has recognized that "where Congress has made its intent clear, 'we must give effect to that intent.'" *Miller v. French*, 530 U.S. 327, 336 (2000), quoting *Sinclair Refining Co. v. Atkinson*, 370 U.S.

195, 215 (1962). In this case, Congress unambiguously expressed its intent for nonprofit HMOs to remain eligible for tax-exempt status when it enacted 26 U.S.C. § 501(m)(3)(B). The Ninth Circuit's decision conflicts with this clear intent.

In 1986, Congress enacted 26 U.S.C. § 501(m) as part of its reconsideration of the tax-exempt status of health care organizations in the United States. The purpose of § 501(m) was to address what Congress deemed to be an unwarranted competitive imbalance between certain tax-exempt commercial insurers — specifically, Blue Cross and Blue Shield entities — and their non-exempt counterparts. In proposing the bill, the House Ways and Means Committee singled-out the Blue Cross and Blue Shield entities by name. H.R. Rep. No. 99-426, at 664 (1985), *reprinted in* 1986-3 C.B. (vol. 2), at 664. The Committee further concluded that such entities are "engaged in an activity whose nature and scope is so inherently commercial that tax-exempt status is inappropriate" and that "the tax-exempt status of organizations engaged in insurance activities provides an unfair competitive advantage to those organizations." *Id.*

To level the playing field, Congress legislated in § 501(m)(1) that an organization can only be tax exempt under § 501(c) "if no substantial part of its activities consists of providing commercial-type insurance." Congress did not, however, simply pull the tax-exempt rug out from underneath the Blue Cross and Blue Shield entities. Rather, it enacted 26 U.S.C. § 833, entitled *Treatment of Blue Cross and Blue Shield Organizations, Etc.*, which established a special tax framework to facilitate the transition of Blue Cross and Blue Shield entities to non-exempt tax status.

When Congress revoked the Blue Cross and Blue Shield entities' tax-exempt status by enacting 26 U.S.C. § 501(m), it also included provisions — § 501(m)(3)(A)-(E) — designed specifically to protect the tax-exempt status of other entities, including nonprofit HMOs. To ensure that nonprofit HMOs continued to be eligible for tax-exempt status, 'Congress enacted § 501(m)(3)(B), which provides that "commercial type insurance' shall not include"

> "incidental health insurance provided by a health maintenance organization of a kind customarily provided by such organizations."

Congress's intent in enacting this provision is unambiguous. Congress intended for nonprofit HMOs to continue to be eligible for tax-exempt status.

By making it impossible for nonprofit HMOs to qualify for tax-exempt status under 26 U.S.C. § 501(c), the Ninth Circuit's decision not only fails to give effect to Congress's intent, it also renders 26 U.S.C. § 501(m)(3)(B) meaningless. As this Court held in *Freytag v. Commissioner*, courts should not "interpret a statutory provision so as to render superfluous other provisions in the same enactment." 501 U.S. 868, 877 (1991), *quoting Pa. Dept. of Welfare v. Davenport*, 495 U.S. 552, 562 (1990). Here, the Ninth Circuit has interpreted 26 U.S.C. § 501(c) so as to render superfluous § 501(m)(3)(B). Section 501(m)(3)(B) only applies to one category of entities — nonprofit HMOs that are tax exempt under § 501(c). The statutory provision protects those nonprofit HMOs from having their tax-exempt status revoked by the "commercial insurance" exclusion embodied in § 501(m)(1). If, as the Ninth Circuit held (Pet. App. 2a), § 501(c) does not apply where the primary purpose of the entity is to establish a fund from

payments by subscribers to defray and assume the costs of health care for those subscribers, then no nonprofit HMO would be able to qualify under § 501(c) and § 501(m)(3)(B) would have no purpose or meaning. The Ninth Circuit does not address this irreconcilable conflict between the effect of its decision and Congress's intent. Nor does the Ninth Circuit explain why Congress would bother to specify protections for nonprofit HMOs in § 501(m)(3)(B) if no nonprofit HMO could qualify for tax-exempt status under § 501(c) in the first instance.

The plain text of § 501(m)(3)(B) is not the only compelling evidence that Congress intended for nonprofit HMOs to continue to be eligible for tax-exempt status. Congress's intent is further confirmed by 26 U.S.C. § 833. In § 833, Congress conferred special tax status on Blue Cross and Blue Shield entities to ease their transition to nonexempt status. By enacting § 833, Congress acknowledged and ameliorated the difficulties imposed on entities that, after having had tax-exempt status for decades, were suddenly deprived of that status. Congress made no similar provision for nonprofit HMOs such as VSP. Given the precedent Congress set by enacting special tax provisions for the Blue Cross and Blue Shield entities, it seems unlikely that Congress foresaw, much less intended for, the Ninth Circuit's wholesale revocation of tax-exempt status for the industry of nonprofit HMOs without enacting similar tax provisions to ease the transition of these nonprofit HMOs to non-exempt status.

Legislative history also confirms that Congress intended for nonprofit HMOs to continue to be eligible for tax-exempt status. In the Conference Report for the Technical and Miscellaneous Revenue Act of

1988, Congress reaffirmed its intent to maintain tax-exempt status for nonprofit HMOs in general, and vision care HMOs such as VSP, in particular.

> "Under the 1986 Act, the provision relating to organizations engaged in commercial-type insurance activities did not alter the tax-exempt status of health maintenance organizations (HMOs). HMOs provide physician services in a variety of practice settings primarily through physicians who are either employees or partners of the HMO or through contracts with individual physicians or one or more groups of physicians (organized on a group practice or individual practice basis). The conference agreement clarifies that, *in addition to the general exemption for health maintenance organizations, organizations that provide supplemental health maintenance organization-type services (such as dental or vision services) are not treated as providing commercial-type insurance if they operate in the same manner as a health maintenance organization.*" H.R. Conf. Rep. No. 100 - 1104, at 9 (1988), *reprinted in* 1988 U.S.C.C.A.N. 5048, 5069 (emphasis added).

Thus, Congress has stated its intent for there to be a "general exemption for health maintenance organizations." This statement by Congress cannot be reconciled with the Ninth Circuit's decision, which (as discussed at pp. 9-10, *supra*) would deny tax-exempt status to any entity based solely on the fact that the entity satisfies the minimum federal statutory requirements to qualify as an HMO. Additionally, Congress singled out supplemental health maintenance organizations that provide vision care as an example of the kind of HMO that should

continue to be tax-exempt. VSP is the nation's largest vision care HMO. As a result, this Conference Report provides compelling evidence that Congress intended for VSP and similar vision care HMOs to retain their tax-exempt status.

In short, the Ninth Circuit's decision raises an issue of national importance. It is at odds with a body of tax law that has been settled for decades. It portends the revocation of tax-exempt status for nonprofit HMOs throughout the country. And perhaps most significantly, it delivers a terrible blow to charities performing important work throughout the United States. VSP's Sight for Students program, which has improved the eyesight of nearly half a million children, is representative of the good work imperiled by the Ninth Circuit's decision. The decision itself is erroneous. The Ninth Circuit's holding — that nonprofit HMOs cannot qualify for tax-exempt status because their primary purpose is to provide health care to paying members — contravenes Congress's intent and renders a statutory provision, § 501(m)(3)(B), meaningless. Accordingly, this Court should grant VSP's petition for a writ of certiorari in order to reverse the Ninth Circuit's decision.

CONCLUSION

For these reasons, the Court should grant the petition for a writ of certiorari.

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